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MONTHLY PROJECTIONS October 1986

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For Release: October 27, 1986

JAPANESE INVESTORS BEGINNING TO INFLUENCE AMERICAN ECONOMY

It was bound to happen. Through much of October investors were becoming increasingly concerned that a burgeoning supply of government financing would be met by inattention from Japanese investors. As a result, many portfolio manager decided not to purchase bonds. The result was a significant increase in long-term interest rates on treasury issues. Other long-term rates rebounded much less significantly, with virtually no rebound being recorded in mortgage instruments.

Reasons for expected Japanese wariness about investing in the United States included concern that the yen would continue rising, leading to lack of attractiveness for dollar-based assets. Also, the Japanese investor was having attention diverted by the Hirohito commemorative coin and by gold speculation. The coin itself apparently exhausted 200 tons of gold, but Japanese speculators increased their holdings by nearly three times that amount. This dramatic increase in gold purchases not only increased the price of the metal, but also raised prospects that funds would not be available for investing in American securities.

While Congress was waiting to approve an increase in the debt ceiling, thereby permitting further issuance of treasury debt, the Japanese investor began paying for gold holdings by reducing stock purchases in Japan. Soon, a decline in values of Japanese securities led to fund withdrawals by European investors. As a result, the Japanese stock market declined sharply value during in the middle of October. Furthermore, as foreigners began withdrawing from Japanese securities, the yen's value began to weaken against the dollar. Now, Japanese investors will be actively interested in the U.S. quarterly funding. As a result, bond prices in the United States have firmed despite a dramatic increase in government supply.

Because inflation has modestly accelerated as a result of a firming of oil prices and because the U.S. economy will be increasing inventory investments to replace the inventory utilized in selling 16.1 million automobiles at annual rates in September, the government's supply of borrowings may still coincide with increasing private demand for funds. Therefore, a modest further increase

in long-term interest rates may develop as the quarterly funding commences. However, with renewed eagerness by Japanese investors, the quarterly funding should be successfully placed and interest rates should begin declining significantly following that event.

The above contortions indicate that foreign investors and their investing behavior more dramatically influence activity in American markets than in previous business cycles. A change in the investment climate in Japan now materially influences interest rates in the United States.

On the surface, the GNP release of third quarter economic activity would be indicative of significant economic strength ahead. Final demand after inflation increased 4.6%. As overall economic activity expanded only 2.4%, significant inventory liquidations occurred during the quarter. Now that inventories are at relatively low levels, many automobile dealers have less than a thirty-day supply of product, production normally should surge to rebuild the warehouse holdings to support higher sales levels. Unfortunately, a spurt in sales was heavily concentrated in consumer spending, which expanded 7% after inflation adjustment. This spurt caused the savings rate to fall below 3% for the quarter and below 2% for September. In effect, consumers felt that automobile incentives were too good to ignore and sharply depleted their savings in an effort to purchase their desired automobiles with unusually low financing charges. Now that the incentives are over, consumer sales will slow sharply, probably contributing nothing to economic growth during the fourth quarter. Therefore, inventories can be replenished with only minor increases in production because sales will fall significantly. While business fixed investment may expand \$3 billion during the fourth quarter, and the trade balances also should improve by \$3-\$5 billion, final sales probably will grow less than 1%.

Surprisingly, the price data that was made available for September indicates that consumers were incorrect in responding to the financing incentives. While financing definitely was a bargain, the automobiles were not. According to the PPI, end-of-year incentives were only 4%. This is nearly a percentage point less than normal year-end incentives provided. The CPI also indicated that prices of new cars rose after seasonal adjustment in September, although auto financing fell by 6.1%. In other words, the financing incentives were largely paid by failing to discount automobiles at the end of their model year. If the price statistics are correct (our surveys suggest that they probably understated the magnitude of incentives but not by a dramatic amount) then the surge in automobile sales to 16.1 million units during September will not fit easily into anyone's econometric models for automobile behavior.

The outlook for 1987 depends upon the magnitude of improvement generated in U.S. trade accounts. Some forecasters are suggesting that real exports will grow at double digit rates throughout the year. Several factors suggest that real exports will grow more rapidly than previously. The dollar's decline clearly has improved American competitiveness, although the recent rally of the dollar against other currencies may blunt the magnitude of competitive gains. Also, the five-year farm bill provided price signals that indicated American products would continue to fall in price through the 1986 harvest year. Therefore, traditional purchasers of American agricultural products abandoned their normal buying patterns in the spring and summer to await lower prices of American goods in the fall. Now that the fall has arrived and many of those price supports have been abandoned, a significant rebound in agricultural sales should materialize. Nevertheless, world GNP probably will be growing only

slightly more than 3% and world trade probably will not be expanding in excess of 4%. Therefore, a sharp rebound in exports from the United States would require American displacement of foreign producers in foreign markets. Normally, such displacement can occur when growth rates are above normal, but are extremely hard to achieve when growth rates are falling below normal. Therefore, export growth probably will only expand in the vicinity of 6%.

It must also be recognized that during much of 1986, oil importers into the United States reduced their purchases in anticipation of further price weakness. Now that oil prices appear to be stabilizing through the heating season, purchases will begin to increase. In addition, the August trade figures occurred with oil being delivered at \$11.77 per barrel. Imported oil prices probably are close to \$15 per barrel at the present time. As a result, the volume and value of imports will not be falling as sharply as many analysts anticipate. The improvement on the current accounts should be less than \$20 billion and the contribution to real GNP will only be about 1%.

Of course, an improvement in the trade accounts is a dramatic reversal from the decline in trade that subtracted nearly 1.5% from GNP in 1986. However, construction will fall sharply in 1987 as that industry seeks to lower vacancy rates for their product because of changing tax benefits for constructing such product. Construction, whose growth added one percentage point to GNP in 1986 may be removing nearly 1 percentage point from GNP in 1987. In addition, savings rates almost certainly will rise in 1987 from 1986 averages. This would suggest that consumer spending probably will contribute about a percentage point less to GNP expansion than in 1986. Other fixed investment also will stagnate, although the sharp decline in oil and gas exploration that deeply depressed the nonresidential component of fixed investment in 1986 should not be a significant factor in 1987. When all the plusses and minuses are put together, it appears that economic activity in 1987 will be growing at a slightly slower rate than in 1986.

Of course, the latest flurry in the dollar's strength against other currencies will forestall any significant resurgence of inflationary pressures. Wage costs are growing slightly less in 1987 than in 1986 while productivity gains probably will be comparable during the two years. On the other hand, the absence of further declines in oil prices will remove a factor that caused inflation to slow by 1.6 percentage points in 1986. In addition, the dollar's decline in value will be contributing more to imported inflation than occurred in 1986. When all these factors are put together, the inflation rate in 1987 appears to be in the vicinity of 3.5%.

Quarterly Profile of GNP

	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	1986 <u>Annual</u>	1987 <u>Annual</u>
Real:	2.4	2.8	1.9	1.0	1.3	2.6	1.8
Price:	3.6	3.4	3.4	3.7	4.1	2.7	3.5
Nominal:	5.7	6.4	5.3	4.8	5.5	5.4	5.4

Monthly Statistical Highlights for October 1986

Payroll employment +120,000; index of hours worked +0.1%; household employment +103,000; civilian unemployment rate 7.1%; personal income +0.4%; savings rate 3.6%; personal consumption -1.4%; retail sales -4.7%; auto sales 10.2 million; housing starts 1.0%; housing permits -1.1%; construction expenditures -0.4%; business inventory +0.1%; orders for durable goods -2.3%; orders for nondefense capital goods -4.2%; industrial production +0.3%; CPI +0.3%; PPI +0.1%; consumption deflator +0.3%; leading indicators +0.3%; real GNP +0.7%; M1 +17.7%; M2 +8.7%.

Monthly Statistical Highlights For November 1986

Payroll employment +215,000; index of hours worked +0.2%; household employment +291,000; civilian unemployment rate 7.0%; personal income +0.4%; savings rate 4.1%; personal consumption -0.3%; retail sales -1.7%; auto sales 9.3 million; housing starts -1.6%; housing permits -3.1%; construction expenditures -0.4%; business inventory +0.5%; orders for durable goods -0.6%; orders for nondefense capital goods -1.2%; industrial production +0.1%; CPI +0.4%; PPI +0.4%; consumption deflator +0.3%; leading indicators +0.1%; real GNP 3.0%; M1 6.9%; M2 6.9%.

COMMENTARY

Employment - Initial unemployment claims continue to fluctuate near 370,000. The insured unemployment rate has fallen to 2.8% which is consistent with unemployment between 7.0% and 7.1%.

Personal Income and Outlays - Property income fell more than \$3 billion in September as interest rates continued to recede. More modest declines in interest income are expected in the next few months, although property income will continue falling. Farm income rose in September and should rise slightly further in the fourth quarter as a result of firming livestock prices. Strong gains are continuing in nonfarm proprietor's income, suggesting that small business earnings are relatively robust. Nevertheless, income other than wages probably will be growing only between \$4-\$5 billion per month until the first of next year.

As expected, consumer spending surged in September with automobile units selling at 16.1 million. Automobile sales during the first twenty days of October were selling at slightly more than a 10 million rate, indicating a sharp collapse in consumption spending. The collapse will be even more dramatic in retail sales, where a record plunge of 4.7% is anticipated for October. Excluding automobiles, sales were relatively weak in September, but it is not unusual for strength in automobiles to detract from spending in other sectors. Thus, nondurables should rebound in October. The strength of nonauto durables appears to reflect earlier housing starts activity. As housing starts now are beginning to trend downward, a slowing in nonauto durables should become apparent. However, sales tax deductibility, which is only available until the end of this year, may keep durables other than automobiles at a high clip until early next year. Activity then should fall during the first quarter.

Were consumers fooled in the incentives during September or did the BLS incorrectly measure the price changes for automobiles and for auto financing?

Probably, a little of both occurred. Our samples show that pricing incentives for September were 7%, not the 4% contained in the BLS PPI report. On the other hand, consumers failed to recognize that much of the deep financing discounting was coming at the expense of dealer incentive programs at the end of a model year. It is apparent that a \$1000 reduction in financing charges will stimulate more automobile selling than a \$1000 reduction in the base price of the automobile. This apparent lack of transitivity in consumer spending patterns may be related to the failure of consumers to fully recognize a price discount. Dealer "bargaining" provides informational problems in evaluating the true cost of an automobile. On the other hand, most customers can recognize that an interest rate charge is significantly lower than charges that would have to be paid elsewhere. This suggests that periodic financing incentives will be used by the automobile industry to remove excess inventories. As a result, bankers will lose a significant portion of business, although they still will be able to finance used cars.

Construction - Some of the September weakness in housing starts may be the result of weather. Single family permits increased slightly in September although single family starts fell sharply. On the other hand, the sharp decline in multiple family starts and permits to nearly 550,000 probably reflects the beginning of construction decay in that sector. We expect that multi-family starts will fall below 500,000 in 1987. It is also clear, however, that single family starts will be growing at a reduced rate now that real disposable income will be growing more slowly in 1987 than in 1986. Most of the weakness is expected to occur in the south, where starts exceeded permits by nearly 100,000 in September. By contrast, activity should rise slightly in the northeast and the west.

Business Activity - Some of the September strength in durable goods is misleading, as it shows both a bunched order for commercial aircraft and significant shipments of automobiles. Chrysler ran out of 1986 model cars and hurried shipments of 1987 cars to the dealers. This created an unseasonal rate of delivery, which is also counted as an order in the manufacturing report. Therefore, durable goods should fall significantly in October. Nevertheless, the 4.9% surge in durable goods orders was relatively widespread and suggests that more substantial gains will occur in capital goods spending than had previously been anticipated. Indeed, capital goods may increase slightly in 1987.

Business inventories were unchanged in August as automobile inventories began to be liquidated. They should fall sharply at the wholesale and retail level in September. Inventories will only marginally increase in October but then should rise sharply for the remainder of the quarter.

Industrial production in September increased 0.3% for consumer goods as automobile assemblies were at 7.7 million units. Assemblies probably will rise to slightly more than 8 million units in the next few months to rebuild auto inventories. Plant and equipment activity increased 0.3% while materials activity also expanded by a similar amount. The overall index only rose 0.1% as mining continued to subtract from activity. Now that rig counts are beginning to rise, mining should stabilize. As a result, the 0.3% growth currently developing in other sectors should be reflected in changes of the entire index until the end of the year. Some inventory imbalances are expected to develop early in 1987 that will require production curtailments. Thus, industrial production is not expected to show significant growth in 1987.

Prices - Automobile prices fell less than anticipated in September, but this will merely mean that they will grow less than expected in October. The overall inflation outlook is not significantly changed. The Consumer Price Index may grow a bit more rapidly than previously anticipated as a result of more substantial gains in rent than previously projected. These gains are associated with the impact that tax reform will have upon rental property construction. The dollar's current surge against several currencies, while expected to be short-lived, will moderate any inflationary pressures that otherwise will appear on internationally traded commodities. Therefore, the Producers Price Index probably will be growing at a slower rate than previously anticipated well into 1987.

Miscellaneous - Although trade balances improved significantly, much of this gain was the result of a decline in auto deliveries. In addition, the United States continued to trans-ship gold to Japan which continued to increase exports in August but had no impact on imports because the gold already had been received in the United States in earlier months. Oil prices are expected to rise during the fall, leading to increases in the value of imports. Nevertheless, the declining dollar should gradually cause a decrease in merchandise trade balances.

Financial Markets

As mentioned above, concern about increased borrowing by the Federal government has led to a significant increase in long-term interest rates. The Federal Reserve has decided to continue accommodating short-term credit market pressures. These pressures have intensified, leading to a re-acceleration of money growth. More significantly, currency growth has re-accelerated to more than an 8% path, suggesting that the transaction's demand for money has increased. This probably is related to the increase in oil prices and the inventory rebuilding required now that consumers have responded to auto incentives. While interest rates could remain high during the fourth quarter, inventory liquidations once again may reappear early in 1987. More substantially, a slide in construction activity will put significant downward pressures upon rates, at least during the first half the year. If inflation firms later in the year, as anticipated, both short- and long-term interest rates could then increase. However, weakness early in 1987 could be sufficiently troublesome to encourage the Federal Reserve to lower the discount rate.

Equity Markets - According to our analysis, real earnings are growing modestly at the present time. The increase in long-term interest rates should, therefore, exert downward pressures upon equity values. To some extent, these downward pressures have not been intense because foreign investors continue to be attracted to American financial assets. However, tax reform changes will still cause significant tax selling to lock in capital gains before the end of 1986. As interest rates will be trending downward at the end of this year according to our analysis, the degree of decline in equity values should not be substantial. When interest rates fall further early in 1987, the stock market could spurt to new highs by the spring. Later in the year, improved earnings prospects will compete with gradually rising interest rates. Nevertheless, increasing earnings prospects will probably be more dominant, leading to a Dow Jones in excess of 2100 by the fall.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	99783	99783	117.8	117.8	108892	108892	7.1	7.1	168.4	168.4
May	99908	99918	117.7	117.7	109110	109110	7.3	7.3	168.6	168.7
June	99819	99843	117.5	117.3	109673	109673	7.1	7.1	169.4	169.2
July	100223	100105	118.0	117.9	109889	109882	6.9	6.9	169.8	168.9
August	100464	100261	118.3	118.4	110016	110155	6.9	6.8	170.1	169.2
September	100705	100368	118.6	118.4	110221	109891	7.0	7.0	170.3	169.7
October	100826	100488*	118.7	118.5*	110367	109994*	7.0	7.1*	170.8	170.2*
November	100878	100703	118.8	118.8	110456	110285	7.1	7.0	171.3	170.7
December	100963	100882	118.8	119.0	110578	110495	7.1	7.0	171.7	171.1
January 1987	101138	101026	119.0	119.1	110794	110668	7.1	7.0	172.2	171.6
February	101360	101305	119.3	119.4	111053	110973	7.0	6.9	172.6	172.0
March	101585	101468	119.5	119.6	111387	111190	7.0	6.9	173.0	172.4
April	101716	101617	119.7	119.8	111453	111320	7.0	6.9	173.5	172.8
May	101829	101802	119.8	120.0	111548	111548	7.0	6.9	173.9	173.2
June	101960	101993	119.8	120.2	111642	111777	7.0	6.8	174.4	173.6
July	102128	102117	120.0	120.3	111863	111923	7.1	6.8	174.9	174.1
August	102310	102304	120.3	120.5	112016	112166	7.0	6.8	175.4	174.7
September	102492	102486	120.5	120.7	112241	112399	7.0	6.8	176.0	175.2

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	3.485	3.487	2.053	2.055	182.4	183.3	2.987	2.986	2.805	2.803
May	3.476	3.481	2.056	2.058	151.6	152.3	2.976	2.977	2.824	2.825
June	3.479	3.482	2.063	2.063	133.2	123.7	2.975	2.972	2.842	2.848
July	3.498	3.493	2.075	2.072	139.2	110.9	2.986	2.979	2.847	2.868
August	3.516	3.500	2.083	2.083	137.8	95.0	2.998	2.981	2.860	2.886
September	3.534	3.512	2.092	2.090	135.5	56.6	3.011	2.988	2.876	2.932
October	3.547	3.527*	2.100	2.100*	136.1	107.4*	3.024	3.000*	2.888	2.893*
November	3.567	3.541	2.108	2.113	131.1	124.3	3.038	3.010	2.907	2.886
December	3.587	3.563	2.116	2.123	127.3	124.8	3.054	3.029	2.928	2.904
January 1987	3.598	3.576	2.126	2.132	154.2	148.4	3.098	3.063	2.944	2.915
February	3.624	3.597	2.138	2.144	172.5	144.5	3.123	3.087	2.951	2.943
March	3.650	3.614	2.150	2.154	188.4	139.2	3.147	3.102	2.959	2.963
April	3.660	3.634	2.158	2.165	176.2	142.3	3.154	3.119	2.978	2.977
May	3.669	3.648	2.167	2.173	165.2	138.4	3.163	3.130	2.998	2.992
June	3.679	3.664	2.176	2.184	153.9	135.7	3.170	3.144	3.017	3.008
July	3.696	3.682	2.186	2.193	150.5	134.7	3.182	3.159	3.032	3.024
August	3.713	3.702	2.197	2.207	149.3	137.4	3.193	3.176	3.044	3.039
September	3.730	3.718	2.208	2.218	149.6	134.7	3.204	3.189	3.055	3.054

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	2712.0	2710.5	369.7	368.5	920.4	922.1	1421.9	1419.9	2396.1	2396.1
May	2731.0	2731.7	378.9	379.0	925.6	926.6	1426.5	1426.1	2407.6	2410.3
June	2747.3	2753.8	375.4	374.2	931.9	936.4	1439.9	1443.3	2417.3	2418.9
July	2751.8	2772.7	373.8	381.1	927.3	932.8	1450.7	1448.9	2416.0	2433.3
August	2764.4	2790.2	379.6	402.4	927.5	937.2	1457.3	1450.6	2420.7	2443.2
September	2779.1	2834.9	383.3	437.1	932.8	936.5	1463.0	1461.3	2425.0	2474.6*
October	2790.3	2795.2*	379.8	385.2*	937.7	940.6*	1472.8	1469.4*	2426.3	2430.6
November	2808.2	2787.7	381.6	367.4	943.1	942.3	1483.5	1478.0	2433.4	2416.3
December	2828.0	2805.5	384.3	370.2	948.5	945.4	1495.2	1489.9	2442.1	2424.3
January 1987	2843.3	2815.1	388.4	367.0	952.5	949.1	1502.4	1499.0	2449.0	2424.8
February	2849.3	2842.3	384.7	382.0	957.9	953.0	1506.7	1507.3	2447.9	2443.0
March	2857.4	2861.8	383.7	388.3	959.1	956.8	1514.6	1516.7	2446.4	2453.6
April	2875.1	2874.9	385.9	390.4	964.3	960.1	1524.9	1524.4	2453.2	2457.8
May	2894.3	2889.0	388.6	392.4	969.8	963.3	1535.9	1533.3	2461.1	2460.9
June	2912.8	2905.0	392.2	393.9	973.8	967.5	1546.8	1543.6	2468.5	2466.0
July	2926.3	2920.3	393.7	396.1	977.4	970.7	1555.2	1553.5	2471.5	2469.9
August	2937.7	2933.9	391.6	394.3	981.1	975.7	1565.0	1563.9	2472.8	2472.1
September	2947.9	2948.9	388.9	395.3	983.9	980.0	1575.1	1573.6	2473.1	2475.5

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	117.72	117.72	18.52	18.52	11.0	11.0	72.84	72.84	26.36	26.36
May	118.52	118.68	18.38	18.39	11.3	11.3	73.19	73.12	26.95	27.16
June	118.70	118.96	18.25	18.50	11.0	11.1	73.30	73.36	27.16	27.10
July	118.61	119.80	18.28	18.88	10.9	10.7	73.39	73.49	26.94	27.43
August	119.33	121.57	18.40	19.13	11.2	12.7	73.41	73.88	27.52	28.57
September	119.85	127.18	18.65	19.22	11.1	16.1	73.83	73.83	27.37	34.13
October	119.81	121.18*	18.86	19.30*	10.8	10.2*	74.21	74.16*	26.74	27.72*
November	120.46	119.13	18.89	19.42	10.9	9.3	74.64	74.29	26.93	25.42
December	121.21	119.72	19.03	19.50	11.0	9.5	75.07	74.53	27.11	25.69
January 1987	122.01	119.62	19.14	19.36	11.2	9.3	75.38	74.82	27.49	25.44
February	122.00	121.53	18.93	19.27	11.0	10.0	75.81	75.13	27.26	27.36
March	121.98	123.32	19.14	19.33	10.8	10.4	75.91	75.43	26.93	28.06
April	122.65	123.34	19.17	19.40	10.9	10.5	76.32	75.69	27.16	28.25
May	123.41	123.84	19.31	19.46	11.0	10.6	76.75	75.94	27.35	28.44
June	123.96	124.35	19.36	19.55	11.1	10.7	77.07	76.27	27.53	28.53
July	124.43	124.88	19.46	19.63	11.1	10.8	77.36	76.53	27.61	28.72
August	124.47	125.05	19.26	19.62	11.0	10.8	77.65	76.92	27.56	28.51
September	124.56	125.51	19.21	19.68	10.9	10.7	77.87	77.26	27.48	28.57

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	2.019	2.019	1.242	1.242	1.885	1.885	371.6	373.9	331.8	334.0
May	1.861	1.853	1.247	1.241	1.788	1.788	374.7	374.5	331.6	332.0
June	1.845	1.852	1.223	1.230	1.745	1.792	372.9	375.4	328.3	332.6
July	1.840	1.782	1.215	1.137	1.724	1.759	369.2	378.1	324.4	335.2
August	1.855	1.818	1.259	1.199	1.736	1.673	368.6	382.2	323.3	338.1
September	1.858	1.680	1.270	1.116	1.721	1.613	369.8	382.8	323.8	338.2*
October	1.826	1.697*	1.242	1.154*	1.673	1.595*	367.3	381.4*	320.8	336.3
November	1.815	1.669	1.212	1.136	1.656	1.546	366.5	379.8	319.3	334.0
December	1.804	1.610	1.209	1.088	1.651	1.483	365.7	376.9	317.7	330.6
January 1987	1.793	1.563	1.205	1.067	1.583	1.428	365.0	374.4	316.0	327.8
February	1.770	1.586	1.201	1.093	1.581	1.443	365.3	370.7	315.5	324.0
March	1.746	1.590	1.197	1.108	1.552	1.461	365.3	367.6	314.6	320.8
April	1.725	1.642	1.178	1.136	1.536	1.517	364.9	366.3	313.5	318.8
May	1.740	1.629	1.185	1.108	1.541	1.522	364.3	367.8	312.2	319.5
June	1.701	1.587	1.170	1.074	1.557	1.484	363.8	368.7	310.7	319.5
July	1.695	1.609	1.163	1.103	1.563	1.468	364.6	368.9	310.0	319.1
August	1.704	1.645	1.152	1.118	1.560	1.502	365.5	369.5	309.7	319.1
September	1.700	1.667	1.141	1.143	1.546	1.526	366.9	371.7	309.9	320.2

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	133.4	132.8	70.5	70.6	167.8	170.5
May	130.5	130.1	74.4	71.9	169.2	172.5
June	130.7	130.1	73.7	70.8	168.5	174.5
July	126.4	129.8	71.6	72.5	171.2	175.9
August	125.6	131.9	69.9	73.6	173.1	176.7
September	124.9	132.2	69.6	73.5	175.0	177.1*
October	124.2	131.7*	70.0	73.7*	173.1	176.0
November	124.0	131.6	70.7	74.0	171.8	174.2
December	123.8	130.5	71.4	73.8	170.5	172.6
January 1987	123.8	129.3	71.0	73.5	170.2	171.6
February	124.1	129.0	71.3	73.9	169.9	167.8
March	124.1	127.8	71.6	74.0	169.6	165.8
April	124.3	125.9	71.8	74.3	168.8	166.1
May	124.4	125.2	72.1	74.6	167.8	168.0
June	124.5	125.0	72.4	74.9	166.9	168.8
July	125.0	125.1	72.9	75.3	166.7	168.5
August	125.7	125.3	73.3	75.5	166.5	168.7
September	126.5	125.6	73.6	75.8	166.8	170.3

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	279.4	279.4	103.75	103.75	26.18	26.18	27.36	27.36
May	278.4	278.4	102.62	102.62	26.15	26.15	26.58	26.58
June	278.3	278.4	104.77	102.73	26.74	26.42	27.22	27.24
July	278.5	278.6	106.69	106.22	27.16	27.39	27.25	27.42
August	279.0	278.1	105.36	103.85	27.42	26.33	27.34	27.28
September	279.5	277.8	107.52	108.99	27.36	28.63	27.43	27.22
October	280.3	278.0*	107.73	106.53*	27.48	27.43*	27.47	27.36*
November	281.2	278.8	106.96	105.94	27.35	27.11	27.51	27.43
December	282.3	279.6	106.71	106.29	27.26	27.35	27.55	27.50
January 1987	283.5	280.3	107.22	105.46	27.32	27.06	27.50	27.46
February	284.5	281.1	107.89	105.11	27.46	26.93	27.55	27.39
March	285.9	282.0	107.56	104.73	27.43	26.85	27.57	27.36
April	287.1	282.7	107.35	105.18	27.29	27.08	27.53	27.40
May	288.2	283.5	108.41	105.43	27.58	27.17	27.56	27.43
June	289.3	284.3	107.92	105.96	27.53	27.35	27.60	27.54
July	290.8	285.1	107.18	105.58	27.42	27.30	27.67	27.56
August	291.7	286.0	105.93	106.74	27.17	27.84	27.64	27.63
September	293.2	286.8	105.81	106.26	27.12	27.56	27.61	27.69

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.F.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.F.
April 1986	588.6	588.6	7.33	7.33	125.2	124.7	79.4	79.5
May	586.6	586.7	7.49	7.49	124.7	124.2	78.9	79.1
June	585.5	588.9	7.83	7.96	124.1	124.2	78.3	79.0
July	586.2	591.9	7.83	8.08	124.3	124.9	78.3	79.3
August	587.0	591.9	7.85	7.64	124.4	125.1	78.2	79.2
September	587.7	589.4*	7.60	7.67	124.5	125.3	78.1	79.2
October	589.3	590.1	7.89	7.81*	124.8	125.7*	78.1	79.3*
November	591.4	593.0	8.04	7.92	125.1	125.9	78.1	79.3
December	593.7	595.7	8.15	8.06	125.4	126.0	78.2	79.2
January 1987	596.8	598.3	8.20	8.01	125.7	126.0	78.2	79.0
February	599.2	600.9	8.10	8.15	125.9	125.8	78.2	78.6
March	601.3	602.1	8.22	8.20	126.1	125.8	78.1	78.4
April	603.4	603.4	8.28	8.27	125.9	126.0	77.9	78.4
May	606.2	604.5	8.33	8.32	125.7	125.9	77.6	78.1
June	609.3	606.2	8.39	8.35	125.4	126.1	77.3	78.1
July	611.8	607.9	8.47	8.44	124.8	126.0	76.8	77.8
August	614.7	610.2	8.55	8.60	124.5	126.1	76.6	77.7
September	617.4	612.8	8.63	8.53	124.2	126.2	76.4	77.6

Fore. = August Forecast

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PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	325.4	325.4	286.8	286.8	311.3	311.6	113.5	113.7
May	326.0	326.0	288.6	288.6	311.7	311.7	113.8	114.2
June	327.6	327.5	288.5	288.5	311.6	311.6	114.9	114.4
July	327.6	327.6	287.4	287.3	309.2	308.5	114.7	114.7
August	328.3	328.2	288.6	288.3	310.0	307.7	114.9	114.9
September	329.6	329.2	289.5	289.5	308.1	308.8	115.2	115.3
October	330.5	330.5*	290.2	289.8*	310.6	309.7*	115.5	115.7*
November	331.3	331.9	290.9	290.9	310.9	310.5	115.8	116.1
December	332.2	332.8	291.5	291.5	311.3	311.2	116.2	116.4
January 1987	333.3	334.0	292.3	292.7	311.9	311.9	116.5	116.8
February	334.3	334.6	293.1	293.0	312.6	312.0	116.8	117.0
March	335.4	335.5	294.0	293.6	313.3	312.5	117.2	117.3
April	336.5	336.6	295.0	294.2	313.9	313.4	117.6	117.7
May	337.9	337.7	296.2	294.8	314.4	314.2	118.0	118.1
June	339.0	338.9	297.3	296.0	314.9	314.9	118.4	118.5
July	340.0	340.1	298.1	297.1	315.3	315.4	118.8	118.9
August	341.1	341.5	298.8	298.4	316.0	315.9	119.1	119.3
September	342.0	342.7	299.6	299.4	314.6	314.8	119.4	119.7

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	113.2	113.1	104.4	104.4	105.6	105.5	121.5	121.4	112.0	112.0
May	113.4	113.3	104.9	104.8	105.8	105.8	121.7	121.6	113.0	112.8
June	113.7	113.8	105.1	104.9	106.0	106.1	122.1	122.3	113.6	112.9
July	113.9	113.9	105.3	105.5	105.7	106.1	122.6	122.4	113.8	112.8
August	114.2	114.2	105.2	105.8	105.7	106.4	123.1	122.8	114.0	113.0
September	114.6	114.6*	105.4	106.4*	106.1	106.7*	123.5	123.2*	114.2	113.2*
October	115.0	115.0	105.8	106.7	106.5	106.8	124.0	123.6	114.5	113.4
November	115.4	115.4	106.0	106.9	106.9	107.0	124.5	124.0	114.8	113.7
December	115.8	115.7	106.0	107.1	107.3	107.2	125.0	124.5	115.1	114.0
January 1987	116.1	116.1	106.3	107.4	107.5	107.5	125.4	124.9	115.5	114.2
February	116.4	116.3	106.5	107.5	107.6	107.6	125.9	125.4	115.8	114.4
March	116.8	116.6	106.7	107.7	107.5	107.7	126.3	125.9	116.1	114.6
April	117.2	117.0	106.9	107.9	108.1	108.0	126.9	126.3	116.4	114.9
May	117.6	117.4	107.1	108.1	108.7	108.4	127.5	126.8	116.7	115.1
June	118.0	117.8	107.2	108.4	109.3	108.7	128.0	127.3	117.1	115.4
July	118.4	118.2	107.4	108.6	109.5	109.0	128.5	127.9	117.6	115.6
August	118.8	118.7	107.6	108.8	109.3	109.3	129.1	128.5	118.0	115.8
September	119.2	119.1	107.8	109.1	109.7	109.7	129.6	129.0	118.4	116.1

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MISCELLANEOUS

	Merchandise		Leading		Estimated		Estimated		IVA	
	Trade Balance		Indicators		GNP		GNP (1982 \$)		(annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	-14.02	-12.07	178.5	178.5	4167	4161	3671	3660	19.6	19.6
May	-14.27	-14.21	178.8	177.9	4173	4175	3667	3656	2.8	6.7
June	-12.46	-14.17	179.2	177.5	4207	4191	3661	3660	-7.7	2.5
July	-13.66	-16.06	179.6	179.4	4218	4210	3677	3670	-1.3	9.4
August	-12.93	-13.32p	179.9	179.1	4235	4233	3686	3684	15.8	13.6
September	-13.88	-15.05*	180.3	179.3*	4244	4260	3684	3695	22.7	13.0
October	-13.59	-14.66	180.1	179.8	4271	4277	3698	3697	10.3	5.2
November	-13.22	-14.27	180.3	179.9	4293	4302	3707	3706	-7.6	1.3
December	-12.67	-14.06	180.6	179.6	4316	4322	3714	3713	-18.7	-2.7
January 1987	-13.78	-14.53	180.2	179.3	4342	4338	3727	3714	-7.8	-4.3
February	-13.11	-14.29	180.0	179.4	4363	4360	3735	3726	-5.1	-1.7
March	-12.65	-14.03	180.5	179.7	4384	4371	3741	3726	-3.0	0.5
April	-14.06	-13.78	180.2	180.0	4401	4390	3742	3730	-1.6	1.4
May	-12.93	-13.72	179.6	180.2	4418	4406	3744	3731	-1.4	-0.3
June	-13.01	-13.56	179.2	179.8	4435	4426	3746	3735	-2.4	-2.6
July	-14.93	-15.04	178.6	179.5	4454	4443	3749	3737	-5.3	-3.5
August	-13.02	-13.83	178.8	179.7	4474	4467	3757	3744	-6.7	-4.2
September	-12.24	-13.56	179.2	180.2	4494	4491	3764	3752	-8.1	-4.7

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	239.9	239.9	646.1	646.1	2621.6	2622.1	6.99	6.99	6.08	6.08
May	242.3	242.3	658.6	658.6	2647.0	2649.6	6.85	6.85	6.19	6.19
June	244.2	243.4	666.3	666.8	2667.3	2670.6	6.92	6.92	6.27	6.27
July	245.6	245.5	673.7	676.1	2685.0	2699.1	6.52	6.56	5.85	5.86
August	247.2	246.8	679.6	687.8	2702.5	2723.8	6.36	6.17	5.79	5.55
September	248.8	248.6	686.1	693.3	2720.9	2740.6	6.32	5.89	5.81	5.35
October	250.3	250.2*	689.1	702.8*	2735.4	2759.8*	6.48	5.86*	5.93	5.35*
November	251.9	251.5	694.2	706.7	2749.6	2775.1	6.59	5.74	6.07	5.26
December	253.5	252.9	699.3	710.1	2763.5	2788.5	6.52	5.63	6.06	5.17
January 1987	255.2	254.6	704.6	714.9	2784.7	2805.2	6.41	5.58	5.91	5.03
February	256.9	256.3	710.3	719.6	2806.5	2822.0	6.22	5.46	5.79	5.01
March	258.6	257.8	715.4	723.8	2829.2	2838.5	6.51	5.32	5.94	4.86
April	260.3	259.5	718.4	728.3	2843.6	2856.1	6.69	5.26	6.01	4.85
May	262.1	261.2	722.9	733.5	2861.7	2873.2	6.78	5.25	6.04	5.03
June	263.9	263.0	727.4	738.3	2880.7	2890.4	6.87	5.34	6.04	5.17
July	265.3	264.7	733.0	743.0	2898.3	2908.8	6.45	5.42	5.83	5.22
August	266.4	266.0	737.7	747.2	2915.2	2925.2	6.40	5.63	5.80	5.36
September	267.5	267.4	740.6	751.4	2927.0	2941.6	6.42	5.77	5.80	5.49

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	8.79	8.79	7.20	7.20	6.60	6.60	6.60	6.60	8.83	8.83
May	9.09	9.09	7.54	7.54	6.62	6.62	6.65	6.65	8.50	8.50
June	9.13	9.13	7.87	7.87	6.71	6.71	6.73	6.73	8.50	8.50
July	8.94	8.88	7.69	7.51	6.43	6.33	6.47	6.37	8.14	8.16
August	8.83	8.72	7.59	7.21	6.26	5.92	6.34	5.92	8.00	7.90
September	8.77	8.89	7.47	7.11	6.21	5.68	6.30	5.71	8.00	7.50
October	8.89	8.96*	7.51	7.20*	6.53	5.78*	6.63	5.84*	8.00	7.50*
November	9.03	9.05	7.68	7.32	6.62	5.86	6.72	5.90	8.00	7.50
December	9.20	8.89	7.85	7.25	6.55	5.72	6.65	5.80	8.00	7.50
January 1987	8.99	8.76	7.64	7.10	6.36	5.59	6.47	5.69	8.00	7.50
February	8.52	8.53	7.17	6.89	6.17	5.43	6.28	5.50	8.00	7.50
March	8.46	8.47	7.08	6.79	6.53	5.28	6.64	5.36	8.00	7.26
April	8.69	8.55	7.30	6.88	6.74	5.25	6.83	5.29	8.00	7.00
May	8.92	8.62	7.49	6.97	6.83	5.29	6.94	5.34	8.50	7.00
June	8.86	8.60	7.44	6.92	6.95	5.37	7.13	5.43	8.50	7.00
July	8.73	8.66	7.27	7.02	6.42	5.46	6.61	5.51	8.50	7.23
August	8.59	8.69	7.13	7.04	6.37	5.59	6.52	5.65	8.50	7.50
September	8.55	8.87	7.05	7.21	6.35	5.72	6.47	5.80	8.50	7.50

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MONTHLY PROJECTIONS November 1986

Dr. Donald Ratajczak, Director
For Release: December 3, 1986

WILL IMPROVING TRADE BE ENOUGH?

Finally, the long-awaited improvement in international trade appears to have begun with a decline in the deficit to \$12.06 billion in October. To be sure, low trade deficits were announced in two previous months merely to be eradicated when more appropriate information became available. For example, the September report initially showed a deficit of \$12.6 billion, but that was revised to a high deficit of \$14.74 billion. These revisions are caused by processing delays, which are especially significant for the processing of import invoices. In October, however, much of the improvement in the trade accounts occurred on the export side, with exports rising a sharp 10.3%. This suggests that even when all October invoices are finally processed, a significant reduction in the trade deficit will remain.

Certainly, a declining trade deficit is a necessary condition for generating increasing economic growth in 1987. The consumer has shifted from an aggressive leader of economic growth to a more passive position. This is necessitated by debt restraints for those households that do not own significant stocks and bonds and by satiation for most consumers, especially with respect to automobiles, furniture, appliances, and apparel. All of these consumption items had been running above long-term trends in the previous few years. The shift in the consumer from a leader to a passive performer in the economy will eliminate a full percentage point from economic growth in 1987.

In addition, the adverse effects on construction from tax reform will shift the construction industry from adding nearly 0.7% to GNP in 1986 to subtracting more than that amount in 1987 and another 1% from growth in 1988. Thus, the restraint on consumption and construction alone would slow economic growth by 2.5 percentage points in 1987. As government spending is not expected to materially offset the sluggish performance in those important sectors and capital spending will struggle to remain flat, improving trade must develop in order to have any significant economic growth in 1987.

Nevertheless, many analysts are overstating the magnitude by which trade will provide economic stimulus in the next year. While the dollar has fallen sharply against the currencies of most industrialized nations, it has not signi-

ificantly declined against those countries providing most of the industrial materials being imported into the United States. Therefore, the fiber, building material, and metal industries that are facing import competition have received relatively little relief from currency movements. As long as price signals are not being altered, economic flows also should not change.

Another problem associated with improving trade balances is that a significant portion of that improvement reflects gains in agricultural exports. Now that the agricultural policies of the administration have created world prices for American products, orders abroad have increased significantly. Over time, this increased reliance upon American production will stem the current incentives to increase production capability abroad. As a result, world excess capacity in agricultural products will slowly shrink with a significant portion of this capacity shrinkage developing outside the United States. However, the movement toward world prices was achieved while propping up the incomes of farmers. Therefore, the relationship between product prices and incomes in the farm sector have been severed. Thus, low prices for American commodities will have only a limited impact upon restraining production in the United States. Similarly, as world demand gradually improves and begins to increase agricultural prices, production in the United States will be largely unaffected. Rather, increased exports of agricultural products will be developed at the expense of purchases by the Commodity Credit Corporation. In terms of the GNP accounts, agricultural products in the export sector will increase while agricultural products in government expenditures will fall. The level of GNP remains unchanged.

Of course, not all the improvement in trade was in agriculture. The American aerospace industry is beginning to regain its worldwide competitive position. There also appears to be some improvement in industrial materials moving abroad, especially chemicals and paper products. However, imports are continuing to expand. Furthermore, oil imports in both volume and value probably will increase significantly in the next year. Prices in October were at a relatively low \$13.36 per barrel. Current spot prices in the world suggest that delivered oil by January will be in excess of \$15 per barrel. Also, this significant decline in oil prices has dramatically reduced the incentive for gas and oil exploration in the United States. Current industry estimates suggest that well production costs plus compensation for risk require a price of nearly \$20 per barrel to add to gross reserves. As existing reserves are diminished, the prevailing \$15 per barrel suggests that no new reserves will be added to replace that which is exhausted. Therefore, production capability will gradually dwindle. Industry estimates suggest that this dwindling will be between 300,000 and 500,000 barrels a day per year. All of this must be made up by imports. Therefore, significant oil imports will develop in 1987 and beyond.

Of course, if the value of oil imports rises and leads to higher trade deficits than currently, the dollar will merely weaken further to displace other imports and reduce international trade imbalances. In addition, significant gains in dollar holdings abroad will sharply raise factor incomes earned in the United States by foreign investors. In the past year net factor incomes have deteriorated from \$39.1 billion to \$35.3 billion. Further declines in this net factor income position will largely offset any improvement in the trade deficit that develops. Assuming foreign investors will not continue to absorb the current magnitude of American capital assets, this development will lead to significantly lower values for the dollar, resulting in more substantial inflation in 1987 and beyond than most analysts are currently anticipating. Indeed,

a D-mark trading at 1.75 to the dollar and only 135 yen needed to buy the dollar could materialize by the end of 1987.

Nevertheless, there will be a significant contribution to GNP growth as a result of a swing in the trade balances over the next two years. In 1986 the trade accounts subtracted more than a percentage point from economic activity. In 1987, an improving trade picture should add a percentage point to GNP and add a further percentage point to GNP in 1988.

Despite improving prospects for the trade accounts, economic activity almost certainly will slow significantly early in 1987. Late in 1986 short-term credit market pressures began developing as investors tried to build out as much of their construction product as possible at the same time that the automobile and manufacturing industries were rebuilding depleted inventories. However, this upward pressure upon short-term interest rates should dissipate by the end of 1986. Early in 1987 construction weakness should become relatively widespread. In addition, some consumer spending may be shifted into 1986 at the expense of early 1987 as a result of promotions informing the consumer that sales tax deductions will end when 1986 is over.

Weakness developing early in 1987 should lead to a significant decline in interest rates. Indeed, the long-term government bond should fall below 7% sometime in the late winter or early spring months. Enough weakness probably will be generated early in 1987 to entice the Federal Reserve to move one more time toward lower discount rates. As a result, the prime rate probably will fall to 7% early in the year and remain at that level through much of the remainder of the year. However, increasing inflationary concerns toward the end of 1987 may very well lead to rising interest rates at that time.

The outlook for lower interest rates but a weakening economy provides a mixed position for equity values. At the present time the equity markets appear to be uncovering all of the positives and ignoring all the negatives. It is possible that many analysts will be surprised by fourth quarter declines in reported profits as a result of the need to take out the investment tax credit from the earnings in earlier quarters. However, this tax removal cannot be done by restating the previous quarters but rather must be reversed in the quarter where the material change occurred. For many companies this will be on their fourth quarter earnings report. Therefore, the stock market may be vulnerable to some downside potential early in 1987 when these relatively lackluster earnings begin to be announced. Later in the year, the stock market will again be buffeted by offsetting pressures. Economic activity will improve but interest rates probably will be drifting upward. Initially, stock values could rebound in this economic environment. However, possibilities of accelerating inflation early in 1988 (remember, a large social security tax increase is initiated at that time) may very well end further gains in equity values.

Quarterly Profile of GNP

	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1986</u> <u>Annual</u>	<u>1987</u> <u>Annual</u>
Real:	2.9	1.7	1.2	2.4	2.1	1.8	2.6	1.9
Price:	3.6	3.9	3.8	3.5	3.8	4.1	2.8	3.6
Nominal:	6.4	5.7	5.0	5.9	5.9	5.9	5.5	5.5

Monthly Statistical Highlights for November 1986

Payroll employment +147,000; index of hours worked +0.2%; household employment +166,000; civilian unemployment rate 7.0%; personal income +0.3%; savings rate 4.4%; personal consumption -0.1%; retail sales -1.3%; auto sales 9.6 million; housing starts +0.7%; housing permits -1.6%; construction expenditures -0.3%; business inventories +0.4%; orders for durable goods +2.2%; orders for nondefense capital goods +0.2%; industrial production +0.2%; CPI +0.3%; PPI +0.2%; consumption deflator +0.3%; leading indicators +0.1%; real GNP 1.0%; M1 18.5%; M2 10.0%.

Monthly Statistical Highlights For December 1986

Payroll employment +169,000; index of hours worked +0.2%; household employment +185,000; civilian unemployment rate 6.9%; personal income +0.4%; savings rate 4.0%; personal consumption +0.7%; retail sales +1.2%; auto sales 9.9 million; housing starts -0.9%; housing permits -1.2%; construction expenditures -0.1%; business inventories +0.4%; orders for durable goods -0.5%; orders for nondefense capital goods +0.7%; industrial production +0.2%; CPI +0.3%; PPI +0.3%; consumption deflator +0.3%; leading indicators -0.1%; real GNP 2.6%; M1 14.2%; M2 10.0%.

Employment - While payroll employment jumped 298,000 in October, jobs were being substituted for hours. The total index of hours worked remained unchanged, reflecting a dormant economic performance. Our early assessment for November is that payroll employment will grow much more slowly but the work week will become extended, showing much more strength. However, initial unemployment claims have fallen significantly during the month and the insured unemployment rate dipped to 2.6%. This indicates that payroll employment is up in excess of 200,000 and that the civilian unemployment rate will fall to 6.9%. The October employment situation also showed a significant increase in the hourly earnings index. This could be the result of data distortions, assuming that the survey misrepresented the length of the work week. If so, the hourly earnings index should grow much more slowly in the next month. The hourly index is still only 2.6% above previous year levels, but the 0.4% adjusted gain for October is the first troublesome sign of potential wage pressures.

Personal Income - Although wage income grew a healthy \$14 billion in October, \$5.6 billion of that gain was a one-time profit sharing bonus at annual rates received by automobile workers. Thus, the October base must be lowered by that amount before comparing movements in November. Therefore, our projections of a \$5 billion increase in wages is relatively vigorous. On the other side of the spectrum, reduced farm subsidies took \$3 billion out of personal income in October. These subsidies appear to be at seasonally low levels and should no longer reduce personal income gains.

Outlays were surprisingly weak in October. The 2.0% decline in personal consumption was largely anticipated as a result of a significant decline in automobile sales. However, the magnitude of the decline in durable goods expenditures exceeded our previously forecasted amounts. This suggests that durable sales probably will continue to grow less than had been anticipated. Expenditures on services also were unusually low as a lackluster stock market sharply reduced earnings on financial services. A modest rebound is anticipated in November followed by more vigorous gains in the service components in subsequent months. After adjustment for inflation, consumption is expected to fall at an annual rate of nearly 7% during the fourth quarter.

Retail Sales - Most retail sales are mirroring the performance in consumer outlays. Automobile sales slumped sharply following their September surge from incentives. Sales are gradually firming in the latter part of November as some consumers are encouraged to buy automobiles before the sales tax reduction is lost. However, this will merely shift sales from early 1987 into the latter part of 1986. Sales for other durables continue to grow vigorously, although some sales tax shifting may also cause a slight slowing in activity early in 1987.

Construction - Mortgage rates have fallen to 9% on FHA loans and some fixed mortgages are being quoted at less than 9% with two or three points. This normally would mean vigorous single-family activity. However, sales of new homes are showing a little bit of tarnish in October following an especially vigorous rate of sales growth in September. This may explain why single-family permits fell significantly in the last two months. Some rebound is anticipated in single-family activity, but only dramatic declines in interest rates will significantly raise housing activity under current economic conditions and such dramatic declines are not anticipated. Multi-family activity already is slumping sharply as a result of adverse incentives generated by the tax reform package. Permits are expected to fall below 500,000 units by early 1987 and starts should very quickly follow. All housing starts should average approximately 1.6 million in 1987 with slightly more than 1.1 million for single-family units.

Despite the slowing in housing starts, a rush to complete previously started units has significantly raised residential construction expenditures. A similar rush to build appears to be developing for nonresidential properties as well. This is creating significant strength for construction expenditures at present, but this strength should quickly turn into weakness very early in 1987. Already, impending weakness in construction activity is reducing inflationary pressures. In October, the construction deflator showed no change.

Business Activity - Although consumption should fall sharply in the fourth quarter, no economic weakness should occur because business inventories are expected to expand significantly. After a significant period of decline, manufacturing inventories are expected to increase in November. Retail inventories should grow sharply as auto sales plummet while auto production only gradually eases. Excess inventories could begin appearing as early as January.

Orders for durable goods were especially weak in all categories in October. Traditionally, orders tend to fall following an unusually strong month, which occurred in September. This appears to be the result of incentive programs provided to sales people in the previous month. Normally, the month following the completion of such sales incentive programs records a significant reduction in orders. (Some sales people induce customers to shift the timing of their orders in order to help the incentive programs). In addition, defense orders fell sharply following two months of unsustainable increases. The decline in defense orders has now brought those orders \$2 billion below shipments. Clearly, orders will rebound toward shipments in the next few months. An anticipated increase in orders for nondefense capital goods is largely the result of anticipations that machinery will begin performing better in the months ahead than in the past. Offsetting this optimistic outlook for nondefense orders is concern that commercial aircraft orders will slow after an especially vigorous several months of activity.

Industrial production was unchanged in October as production of consumer goods fell by 0.4% even as production of business materials and business equip-

ment showed no change. Leading the decline in consumer goods was a decrease in automobile production to 7.3 million units from 7.7 million units at annual rates a month ago. Further modest production cutbacks in automobiles can be expected, but no decline of the October magnitude should be anticipated. Business equipment probably will increase as some customers wish to receive equipment before depreciation schedules change. This is especially true of trucks. Therefore, a modest rebound is anticipated in industrial activity over the next few months. However, this will be followed by a period of industrial stagnation early in 1987.

Prices - Larger than anticipated increases in new model automobile prices will result in higher estimates of the consumer durables deflator than contained in our forecast. Prices of consumer nondurables currently are higher than had been anticipated as a result of persistent increases in food prices. However, another bout of falling oil prices and moderation in meat price changes over the winter months should bring nondurable prices back to ranges that had previously been expected. On the other hand, plunging natural gas prices and the largest single monthly decline in electricity prices that occurred in October will lead to a lower price increase for the energy component of consumer services next year. Nevertheless, the impact is to slightly increase prices for the consumption deflator. However, prices for the CPI are expected to grow slightly slower than previously forecast as a result of modest price increases for used cars.

Miscellaneous - Our projections for trade balances already have been explained in earlier commentary. In general, exports are expected to improve but imports of oil product also should rise. As a result, improvement in the merchandise trade balances will be more significant than contained in our forecast but will not be very dramatic. As a result, the deficit will fall from approximately \$170 billion in 1986 to \$155 billion in 1987.

Much of the recent rebound in the leading indicators has been associated with growth in sensitive prices following a collapse in cotton prices in August. In addition, unusually low inflation rates have continued to generate significant growth in real money balances. In 1987, however, the absence of a collapse in oil prices should prevent real balances from growing as rapidly as in the present year. Furthermore, the rebound in sensitive prices should be relatively limited. Also, initial unemployment claims are near their low point for this cycle. While they could fall further, the degree to which they can contribute to favorable leading indicator performance is sharply diminished.

Financial Markets

An apparent spurt in inventory rebuilding along with rapid growth in construction expenditures is leading to more significant pressures on short-term credit markets than had been anticipated. As a result, short-term interest rates are drifting upward, placing considerable pressure upon the Federal Reserve. The Federal Reserve has responded to this pressure by modestly increasing the desired trading range for the federal funds rate and also permitting more rapid growth in the money stock than otherwise would prevail. Unlike previous spurts in money growth, a portion of the money growth burst developing in the fall is the result of money demand. Normally, this condition would lead to Federal Reserve restraint and significant increases in interest rates or more inflation not too many months down the road. However, the inventory and construction buildout appear to be temporary. As a result, upward

pressures upon credit markets should ease and the Federal Reserve will be able to significantly slow money growth in the winter months. Indeed, short-term interest rates probably will weaken in the winter, leading to a discount rate cut by the spring.

Long-term interest rates are beginning to perform well in this economic environment. Previous concerns about resurging inflation have subsided. To some extent these concerns were related to gold price movements, which are not as relevant in dictating inflationary pressures at this time as some people expect. In fact, commodity inflation is gradually intensifying, but no serious inflationary pressures are expected to resurface in 1987. Toward the end of the year, however, fears of rising inflation could lead to higher long-term interest rates.

Equity Markets - Real earnings apparently are growing during the fourth quarter. As inflationary concerns have eased, long-term interest rates have also declined. This is an economic environment that tends to lead to significant increases in equity values. In fact, the stock market has performed surprisingly well. However, the sluggish economy early in 1987 should diminish real corporate earnings. In addition, corporations will be facing higher tax charges, not all of which will be passed on to wage recipients or customers in the short-run. Fortunately, declining interest rates should blunt any downward movement in equity values during the first half of 1987. While a sell-off to the 1700 range on the Dow Jones certainly is possible in the winter months, the market then is expected to rebound through much of the rest of the year. Toward the end of the year, when inflation begins intensifying and interest rate pressures begin resurfacing, the stock market may begin to worry about Federal Reserve restraint. However, the market probably will exceed 2100 early next fall before those concerns prevent any further improvement in equity values.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	100105	100105	117.9	117.9	109882	109882	6.9	6.9	168.9	168.9
August	100261	100283	118.4	118.4	110155	110155	6.8	6.8	169.2	169.3
September	100368	100448	118.4	118.3	109891	109891	7.0	7.0	169.2	169.6
October	100558	100746	118.7	118.3	110169	110240	7.0	7.0	169.9	170.3
November	100713	100893*	119.0	118.5*	110235	110406*	6.9	7.0*	170.1	170.5*
December	100868	101062	119.2	118.7	110278	110591	7.0	6.9	170.3	170.8
January 1987	100993	101223	119.3	118.8	110569	110807	7.0	6.9	170.8	171.1
February	101108	101379	119.3	119.0	110799	110981	7.0	6.9	171.3	171.5
March	101223	101506	119.4	119.1	110990	111134	6.9	6.9	171.9	171.9
April	101462	101659	119.8	119.3	111216	111300	6.8	6.8	172.3	172.4
May	101654	101824	120.0	119.4	111452	111493	6.8	6.8	172.6	172.7
June	101846	101993	120.2	119.6	111688	111835	6.7	6.6	173.0	173.1
July	101993	102146	120.4	119.8	111816	111908	6.6	6.7	173.5	173.6
August	102104	102317	120.5	120.0	111945	112029	6.7	6.8	173.9	174.0
September	102215	102469	120.6	120.1	112074	112101	6.8	6.9	174.4	174.5
October	102420	102621	120.8	120.3	112280	112423	6.8	6.8	174.8	174.9
November	102565	102763	121.0	120.4	112483	112609	6.7	6.8	175.2	175.3
December	102711	102924	121.1	120.6	112687	112796	6.7	6.7	175.6	175.7

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	3.493	3.493	2.072	2.072	110.9	117.6	2.979	2.979	2.868	2.861
August	3.500	3.501	2.083	2.083	95.0	93.1	2.981	2.981	2.886	2.888
September	3.512	3.512	2.090	2.088	56.6	60.3	2.988	2.988	2.889	2.928
October	3.527	3.524	2.101	2.102	104.6	123.8	3.001	2.995	2.897	2.872
November	3.544	3.533*	2.108	2.107*	116.3	132.7*	3.014	3.000*	2.898	2.867*
December	3.560	3.547	2.115	2.116	109.4	120.1	3.028	3.009	2.919	2.889
January 1987	3.564	3.557	2.125	2.123	128.3	157.1	3.057	3.048	2.929	2.891
February	3.577	3.574	2.136	2.134	118.8	158.9	3.066	3.063	2.947	2.904
March	3.592	3.587	2.146	2.142	118.9	155.6	3.078	3.073	2.959	2.917
April	3.613	3.605	2.155	2.154	124.2	152.9	3.097	3.087	2.973	2.934
May	3.632	3.618	2.167	2.161	120.3	141.0	3.113	3.096	2.993	2.955
June	3.652	3.636	2.176	2.172	117.3	140.4	3.130	3.110	3.013	2.970
July	3.664	3.653	2.184	2.183	114.7	140.5	3.138	3.123	3.023	2.983
August	3.676	3.671	2.193	2.194	106.6	142.0	3.146	3.137	3.039	2.995
September	3.689	3.686	2.202	2.203	100.3	140.9	3.154	3.148	3.053	3.007
October	3.709	3.704	2.211	2.214	102.8	133.2	3.170	3.162	3.067	3.029
November	3.728	3.719	2.221	2.222	94.2	124.9	3.185	3.173	3.091	3.048
December	3.748	3.738	2.232	2.233	97.0	122.0	3.201	3.188	3.105	3.066

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	2772.7	2765.8	381.1	384.4	932.8	932.8	1448.9	1448.7	2433.3	2428.4
August	2790.2	2791.8	402.4	405.0	937.2	935.6	1450.6	1451.2	2443.2	2445.2
September	2834.9	2830.1	437.1	442.9	936.5	928.1	1461.3	1459.1	2474.6	2466.7
October	2799.1	2773.0	384.3	372.5	944.3	936.3	1470.5	1464.2	2436.1	2405.7*
November	2799.8	2769.3*	379.8	360.7*	941.7	938.1*	1478.3	1470.5*	2428.3	2395.0
December	2820.0	2790.0	382.5	367.3	949.6	943.8	1487.9	1478.9	2437.3	2404.5
January 1987	2829.3	2791.1	379.6	356.3	954.5	947.5	1495.2	1487.3	2437.0	2398.4
February	2846.6	2803.5	384.1	358.4	958.2	949.5	1504.3	1495.6	2443.4	2402.3
March	2858.2	2815.9	386.5	360.9	957.1	950.5	1514.6	1504.5	2445.0	2407.4
April	2871.1	2831.7	389.4	365.7	958.2	952.2	1523.5	1513.8	2449.7	2412.2
May	2891.1	2851.8	393.6	373.4	964.7	955.7	1532.8	1522.7	2462.6	2421.5
June	2909.9	2865.6	393.3	375.1	976.9	958.9	1539.7	1531.6	2470.2	2426.1
July	2919.6	2877.7	395.2	376.2	975.6	960.7	1548.8	1540.8	2470.1	2429.1
August	2935.2	2889.3	396.8	375.2	980.2	964.9	1558.2	1549.2	2474.9	2430.6
September	2948.7	2900.5	399.6	372.9	980.6	968.8	1568.5	1558.8	2477.9	2431.0
October	2962.1	2921.2	397.8	380.9	986.4	972.5	1577.9	1567.8	2480.8	2438.5
November	2984.8	2939.4	405.3	383.4	993.1	977.5	1586.4	1578.5	2491.5	2446.0
December	2998.5	2956.3	404.7	382.5	998.0	984.6	1595.8	1589.2	2494.6	2451.8

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	119.80	119.80	18.88	18.88	10.7	10.7	73.49	73.49	27.43	27.43
August	121.57	121.52	19.13	19.14	12.7	12.7	73.88	73.61	28.57	28.77
September	127.18	128.00	19.22	19.34	16.1	16.1	73.83	73.49	34.13	35.18
October	121.34	121.59	19.15	19.36	10.3	10.3	74.43	73.68	27.76	28.55
November	120.18	120.06*	19.53	19.50*	9.5	9.6*	74.22	73.82*	26.43	26.74*
December	121.54	121.51	19.71	19.66	9.8	9.9	74.85	74.27	26.98	27.58
January 1987	121.16	120.13	19.61	19.55	9.4	9.3	75.23	74.56	26.32	26.02
February	122.00	120.82	19.64	19.52	9.6	9.5	75.52	74.72	26.84	26.58
March	122.21	121.22	19.62	19.56	9.9	9.6	75.44	74.80	27.15	26.86
April	122.64	121.97	19.79	19.62	10.0	9.8	75.52	74.93	27.33	27.42
May	123.67	123.23	19.99	19.76	10.2	10.1	76.04	75.21	27.64	28.26
June	124.59	123.70	20.07	19.90	10.1	10.1	77.00	75.46	27.52	28.34
July	124.71	123.99	20.06	19.86	10.2	10.2	76.89	75.60	27.76	28.53
August	125.28	124.19	20.08	19.85	10.3	10.1	77.26	75.93	27.94	28.41
September	125.45	124.20	20.13	19.89	10.3	10.0	77.29	76.24	28.03	28.07
October	125.89	125.52	20.26	20.00	10.2	10.1	77.75	76.53	27.88	28.99
November	127.31	126.23	19.99	19.86	10.6	10.3	78.27	76.92	29.05	29.45
December	127.63	126.68	20.03	19.92	10.5	10.2	78.66	77.48	28.94	29.28

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	1.782	1.782	1.137	1.137	1.759	1.759	378.1	378.1	335.2	335.2
August	1.818	1.795	1.199	1.186	1.673	1.673	382.2	382.2	338.1	338.1
September	1.680	1.652	1.116	1.100	1.613	1.603	382.8	382.8	338.2	338.2
October	1.694	1.648	1.133	1.106	1.592	1.557	384.3	386.3	338.6	340.7*
November	1.687	1.660*	1.143	1.133*	1.576	1.532*	385.5	385.1*	338.8	338.7
December	1.680	1.645	1.141	1.130	1.583	1.513	385.9	384.6	338.2	337.7
January 1987	1.713	1.643	1.152	1.132	1.567	1.506	383.3	383.1	335.1	335.8
February	1.698	1.622	1.150	1.126	1.569	1.503	380.7	380.0	332.2	332.5
March	1.685	1.625	1.136	1.117	1.543	1.478	378.7	376.6	329.6	328.6
April	1.637	1.645	1.121	1.124	1.517	1.496	379.8	378.1	329.7	329.4
May	1.625	1.608	1.115	1.105	1.483	1.492	379.7	378.4	328.7	329.0
June	1.612	1.598	1.112	1.096	1.472	1.473	379.5	377.9	327.7	327.8
July	1.615	1.604	1.120	1.107	1.470	1.463	377.8	377.4	325.7	326.5
August	1.607	1.609	1.117	1.112	1.463	1.469	376.5	378.0	324.3	326.4
September	1.600	1.570	1.099	1.092	1.438	1.455	375.7	378.3	323.0	326.1
October	1.597	1.581	1.087	1.093	1.445	1.442	376.5	377.5	322.9	325.2
November	1.593	1.599	1.084	1.106	1.452	1.466	377.9	376.6	323.3	323.8
December	1.588	1.626	1.080	1.113	1.455	1.483	379.1	377.5	323.2	323.8

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	129.8	129.8	72.5	72.5	175.9	175.9
August	131.9	131.9	73.6	73.6	176.7	176.7
September	132.2	132.2	73.5	73.5	177.1	177.1
October	132.0	132.7*	74.3	75.7*	178.0	177.9*
November	131.7	133.5	75.2	75.5	178.6	176.1
December	131.2	133.1	76.1	76.4	178.6	175.1
January 1987	130.9	130.8	75.5	77.1	176.9	175.2
February	130.6	128.4	75.1	76.8	175.0	174.8
March	130.4	125.6	75.3	76.6	173.0	174.4
April	130.8	127.1	75.4	77.0	173.6	174.0
May	131.1	127.5	75.6	77.1	173.0	173.8
June	131.2	126.7	75.6	77.4	172.7	173.8
July	130.9	127.2	76.1	76.9	170.8	173.3
August	130.6	128.0	76.6	77.3	169.3	172.7
September	131.0	128.1	77.0	77.8	167.7	172.4
October	131.1	127.3	77.2	78.1	168.2	172.1
November	131.4	126.5	77.6	78.5	168.9	171.6
December	131.6	126.9	78.0	78.9	169.5	171.7

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	278.6	278.6	106.22	106.22	27.39	27.39	27.42	27.42
August	278.1	278.1	103.85	103.85	26.33	26.33	27.28	27.28
September	277.8	276.8	108.99	108.72	28.63	28.22	27.22	27.08
October	278.1	277.1	104.63	102.23	27.42	26.13	27.36	27.50
November	278.5	277.8*	104.28	104.46*	27.05	26.84*	27.21	27.56*
December	279.0	278.4	102.89	103.89	26.43	27.02	27.13	28.03
January 1987	279.8	279.2	103.17	103.17	26.46	26.29	27.19	26.93
February	280.7	280.3	104.93	103.94	26.82	26.17	27.10	26.72
March	281.6	281.1	104.86	104.56	26.95	26.43	27.15	26.89
April	282.9	282.7	106.07	105.23	27.46	26.89	27.39	27.13
May	283.5	283.5	106.89	105.96	27.89	27.16	27.67	27.19
June	284.2	284.4	106.55	105.54	27.90	27.43	27.91	27.34
July	285.7	285.6	105.93	106.07	27.51	27.40	27.84	27.45
August	286.5	286.5	105.46	105.82	27.36	27.52	27.56	27.53
September	287.6	287.3	105.67	105.43	27.45	27.50	27.79	27.56
October	289.0	288.6	106.29	105.96	27.82	27.56	27.85	27.63
November	290.1	290.0	107.43	106.29	27.99	27.43	28.01	27.72
December	291.1	291.1	108.21	106.58	28.13	27.61	28.16	27.84

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	591.9	591.9	8.08	8.08	124.9	124.9	79.3	79.2
August	591.9	591.9	7.64	7.64	125.1	125.1	79.2	79.2
September	590.2	588.4	7.67	7.69	125.3	125.2	79.2	79.2
October	591.5	590.7*	7.92	7.96	125.5	125.2	79.1	79.0
November	593.6	593.0	8.05	7.90*	125.6	125.5*	79.0	79.1*
December	595.9	595.4	8.18	7.94	125.7	125.7	78.9	79.1
January 1987	597.8	597.5	8.21	8.03	125.9	125.7	78.9	78.9
February	599.4	599.8	8.15	8.11	126.0	125.8	78.8	78.8
March	602.3	602.4	8.26	8.20	126.2	125.8	78.8	78.6
April	604.6	603.9	8.30	8.17	126.8	126.0	79.2	78.6
May	606.9	605.7	8.34	8.24	127.4	126.2	79.6	78.6
June	608.7	607.5	8.38	8.30	128.0	126.4	80.0	78.6
July	611.5	609.9	8.46	8.59	128.0	126.5	79.8	78.5
August	613.4	612.2	8.57	8.35	128.0	126.6	79.6	78.4
September	615.7	614.9	8.69	8.53	127.9	126.8	79.3	78.4
October	618.0	617.7	8.42	8.65	127.7	126.8	78.9	78.2
November	619.9	620.1	8.65	8.62	127.7	126.9	78.7	78.1
December	622.6	622.2	9.03	8.80	127.9	127.0	78.7	78.0

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	327.6	327.6	287.3	287.3	308.5	308.5	114.7	114.7
August	328.2	328.2	288.3	288.3	307.7	307.7	114.9	114.9
September	329.2	329.2	289.5	289.5	308.8	308.8	115.3	115.3
October	330.3	329.8	290.4	290.4	310.0	310.0	115.6	115.8
November	331.1	330.8*	291.0	291.0*	310.5	310.6*	115.9	116.1*
December	332.0	331.7	292.0	291.8	311.1	311.3	116.3	116.5
January 1987	333.2	332.8	293.1	292.7	311.7	312.1	116.7	116.9
February	334.4	333.8	294.2	293.5	312.2	312.4	117.1	117.2
March	335.5	334.7	295.0	294.3	312.4	312.0	117.3	117.5
April	336.5	335.5	295.8	294.9	313.0	311.6	117.6	117.8
May	337.4	336.3	296.6	295.6	313.3	312.5	118.0	118.2
June	338.3	337.1	297.4	296.3	313.6	313.3	118.3	118.6
July	339.3	338.0	298.1	297.1	313.9	313.8	118.6	118.9
August	340.2	339.0	298.9	298.0	313.3	314.3	119.0	119.3
September	341.1	339.9	299.6	298.8	311.2	312.4	119.4	119.7
October	342.2	341.0	300.6	299.7	314.3	315.4	119.8	120.1
November	343.3	342.1	301.6	300.5	315.1	316.0	120.1	120.5
December	344.4	343.2	302.5	301.3	315.9	316.6	120.4	120.9

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	113.9	113.9	105.5	105.2	106.1	106.1	122.4	122.3	112.8	112.8
August	114.2	114.2	105.8	105.8	106.4	106.4	122.8	122.7	113.0	113.0
September	114.5	114.7	106.3	106.3	106.7	107.2	123.2	123.2	113.1	113.2
October	114.9	115.3*	106.5	106.7*	106.9	107.5*	123.7	123.5*	113.5	113.4*
November	115.3	115.6	106.3	107.0	107.1	107.7	124.1	123.9	113.8	113.7
December	115.7	116.0	106.2	107.2	107.5	108.1	124.5	124.4	114.1	113.9
January 1987	116.1	116.4	106.5	107.4	107.9	108.3	125.0	124.8	114.4	114.1
February	116.5	116.7	106.7	107.7	108.1	108.4	125.5	125.3	114.6	114.3
March	116.9	117.0	106.9	107.9	108.2	108.5	126.0	125.7	114.9	114.6
April	117.2	117.4	107.1	108.1	108.5	108.9	126.4	126.2	115.2	114.8
May	117.4	117.8	107.3	108.4	108.8	109.2	127.0	126.7	115.5	115.0
June	117.8	118.1	107.5	108.6	109.1	109.5	127.5	127.1	115.8	115.3
July	118.2	118.3	107.6	108.9	109.3	109.8	128.1	127.6	116.0	115.6
August	118.6	118.9	107.8	109.1	109.5	110.1	128.6	128.0	116.1	115.8
September	119.0	119.3	108.0	109.3	109.8	110.5	128.9	128.5	116.3	116.0
October	119.4	119.8	108.2	109.7	110.2	110.9	129.4	129.1	116.6	116.1
November	119.8	120.2	108.4	110.1	110.6	111.1	130.0	129.6	116.9	116.3
December	120.2	120.6	108.6	110.4	111.0	111.4	130.6	130.1	117.3	116.6

Fore. = November Forecast

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	-16.06	-16.06	179.4	179.5	4210	4220	3670	3670	9.4	9.4
August	-13.32	-14.04	179.1	179.3	4233	4243	3684	3684	13.6	13.6
September	-16.67	-14.74	179.3	180.1	4260	4260	3695	3695	-4.1	-2.0
October	-15.62	-12.06p	179.8	180.5*	4276	4282	3699	3698	-6.7	-1.3
November	-15.29	-12.93*	179.9	180.7	4289	4297	3701	3701	-11.3	-5.2
December	-14.84	-13.21	179.6	180.6	4305	4321	3702	3709	-13.5	-6.2
January 1987	-15.29	-12.84	179.3	181.0	4323	4336	3704	3709	-11.6	-3.4
February	-15.07	-12.73	179.4	180.8	4347	4351	3712	3712	-10.8	1.7
March	-14.85	-12.29	179.7	180.5	4370	4372	3725	3721	-9.9	3.2
April	-14.63	-13.06	180.0	180.3	4398	4392	3740	3728	-8.9	0.1
May	-14.41	-13.04	180.2	180.5	4426	4419	3751	3739	-7.3	-2.6
June	-14.18	-12.82	179.8	180.7	4454	4438	3765	3742	-6.7	-4.3
July	-15.86	-14.23	179.5	181.1	4467	4463	3766	3754	-1.2	-3.7
August	-15.27	-13.76	179.7	181.0	4480	4478	3765	3754	-1.3	-2.5
September	-14.68	-13.21	180.2	181.2	4492	4499	3762	3759	-5.0	-6.3
October	-14.72	-12.92	180.6	180.9	4517	4525	3770	3768	-9.9	-8.1
November	-14.64	-12.53	180.9	181.3	4536	4544	3777	3771	-15.6	-9.5
December	-14.56	-12.10	181.3	181.6	4556	4565	3784	3776	-19.9	-11.2

Fore. = November Forecast

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	245.5	245.5	676.1	676.0	2699.1	2699.0	6.56	6.56	5.86	5.86
August	246.8	246.8	687.8	687.6	2723.8	2723.8	6.17	6.17	5.55	5.55
September	248.6	248.6	693.3	693.1	2740.6	2740.2	5.89	5.89	5.35	5.35
October	250.5	249.9	701.8	701.2	2758.4	2764.1	5.83	5.85	5.30	5.26
November	252.9	252.2*	707.3	711.2*	2773.5	2786.5*	5.76	5.93*	5.20	5.38*
December	255.3	254.1	712.8	719.1	2788.2	2808.8	5.68	6.04	5.16	5.44
January 1987	256.4	255.8	719.2	722.6	2804.6	2825.7	5.37	5.72	4.91	5.21
February	257.3	257.0	723.0	727.3	2822.5	2844.1	5.20	5.61	4.95	5.14
March	258.3	258.2	727.8	731.2	2840.8	2859.4	5.16	5.50	4.99	5.07
April	260.1	259.6	732.9	736.0	2859.3	2878.2	5.22	5.32	5.02	5.01
May	262.0	260.9	736.5	739.9	2876.9	2893.5	5.27	5.26	5.03	4.97
June	263.9	262.3	740.1	744.4	2894.5	2911.1	5.33	5.35	5.05	5.02
July	265.2	264.0	744.3	747.9	2910.6	2928.6	5.50	5.38	5.30	5.06
August	266.7	265.5	747.6	751.4	2923.9	2942.3	5.56	5.46	5.34	5.22
September	268.3	267.1	750.9	755.9	2937.2	2959.9	5.62	5.57	5.38	5.34
October	269.9	268.8	756.0	760.2	2956.1	2976.7	5.65	5.72	5.30	5.51
November	271.2	270.3	762.1	763.6	2974.5	2994.6	5.69	5.70	5.26	5.46
December	273.5	271.9	768.1	768.1	2992.8	3012.2	5.73	5.63	5.22	5.43

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	8.88	8.88	7.51	7.51	6.33	6.33	6.37	6.37	8.16	8.16
August	8.72	8.72	7.21	7.21	5.92	5.92	5.92	5.92	7.90	7.90
September	8.89	8.89	7.11	7.11	5.68	5.68	5.71	5.71	7.50	7.50
October	8.93	8.86	7.06	7.08	5.73	5.68	5.75	5.69	7.50	7.50
November	8.76	8.79*	6.89	6.93*	5.70	5.75*	5.72	5.80*	7.50	7.50*
December	8.53	8.65	6.65	6.79	5.64	6.03	5.67	6.06	7.50	7.50
January 1987	8.56	8.57	6.68	6.71	5.30	5.67	5.26	5.76	7.39	7.50
February	8.50	8.51	6.61	6.64	5.17	5.56	5.15	5.59	7.00	7.50
March	8.60	8.45	6.71	6.59	5.12	5.43	5.12	5.48	7.00	7.50
April	8.65	8.36	6.76	6.49	5.17	5.37	5.20	5.43	7.00	7.26
May	8.57	8.29	6.69	6.43	5.26	5.30	5.33	5.39	7.00	7.00
June	8.62	8.42	6.75	6.44	5.35	5.39	5.41	5.51	7.00	7.00
July	8.97	8.56	7.23	6.53	5.63	5.45	5.69	5.58	7.08	7.00
August	9.20	8.75	7.44	6.69	5.68	5.58	5.80	5.69	7.50	7.00
September	9.22	8.89	7.47	6.85	5.70	5.73	5.84	5.82	7.50	7.21
October	8.99	8.85	7.24	6.90	5.73	5.76	5.86	5.87	7.50	7.50
November	8.90	8.92	7.14	6.96	5.75	5.68	5.89	5.76	7.50	7.50
December	8.87	8.90	7.10	6.96	5.72	5.60	5.85	5.72	7.50	7.50

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MONTHLY PROJECTIONS December 1986

Dr. Donald Ratajczak, Director
For Release: January 2, 1987

INACTIVE FEDERAL RESERVE SEEN IN FIRST QUARTER

Although challenged by some analysts who believe that tax shifting was not as extensive as advertised, the consensus continues to believe that activity during the fourth quarter has been strengthened at the expense of the first quarter of 1987. As a result, the economy during the early months of 1987 will be growing at such a reduced level that further Federal Reserve stimulus will be required according to this reasoning. Our own projections are sympathetic with the argument that expenditures have been shifted into the last months of 1986. Unsustainably low savings rates have been generated by consumers acquiring cars before sales tax deductions are eliminated. A sharp decline in consumer spending almost certainly will develop during the first quarter. Increasing orders and shipments for durable goods also appear to be related to efforts to receive equipment before less generous depreciation schedules are initiated. According to our projections, shipments will be higher in December than in any month during 1987. Moreover, defense shipments have temporarily spurted, although for non-tax reasons. We also believe that construction will begin declining significantly as the new year begins. Declining housing starts already assures some falloff in residential construction while heavier tax problems will slow construction for nonresidential activity. However, nonresidential orders do not yet indicate that a significant falloff in construction is imminent. Even business inventories, which had been declining most of 1986 began rebounding during the fourth quarter. A modest slowing in inventory investment appears likely early in 1987.

In short, the economy probably will slow its rate of growth significantly early in 1987. Our own estimates show a gain of only 1% during the first quarter following a 3.1% rate of expansion in the fourth quarter. This is the type of slowing that might lead to further Federal Reserve initiatives to reduce the discount rate and stimulate the economy.

However, three forces will be working against Federal Reserve initiatives to stimulate the economy. First, all the shifting of activity that strengthens the fourth quarter of 1986 at the expense of the first quarter of 1987 leads to only modest economic dislocation for all of 1987. Once consumers are able to

replenish their depleted savings, automobile sales again will rise. Although nonresidential construction may fall all year, residential construction possibly will be rising again late in the year. Our own projections suggest that capital spending programs will be strengthening as the year progresses. In addition, trade balances almost certainly will be improving during the year. Thus, the Federal Reserve has little reason to stimulate an economy that is temporarily sluggish as a result of expenditure shifting. Only when economic activity shows less than desired recovery from the first quarter sluggishness will the Federal Reserve be prone to seek further stimulus.

Second, unusually large trade deficits recorded late in 1986 suggest that the dollar has not yet fallen sufficiently against other currencies to improve America's trade balances. However, rising sensitive prices suggest that the dollar has fallen sufficiently to rekindle modest industrial inflation in some basic commodities in the United States. The Federal Reserve is more likely to be concerned about the inflationary fallout from further weakness in the dollar's value than about the need to press the dollar downward. Indeed, the dollar probably will fall without Federal Reserve help. Therefore, the Federal Reserve probably will not threaten a runaway collapse in the dollar's value by pushing down a currency that already is falling. The Federal Reserve might respond with lower interest rates if the dollar stages a significant rally against other currencies, but large trade deficits and the resulting current account deficits preclude such prospects from developing in 1987.

Third, inflation is beginning to heat up modestly. Not only are sensitive prices beginning to intensify but oil prices have rebounded from less than \$12 per barrel in September to the vicinity of \$18 per barrel at the present time. This increase in the price of oil will be reflected in 6¢ - 8¢ increases in the price of gasoline and fuel oil. These gains, in turn, will add about 0.6 percentage points to the CPI and 0.8 percentage points to the PPI in the next few months. As those indices would have increased 0.3% without the addition of rising oil prices, price gains for January and February could be at annual rates of 7% for the CPI and approaching 10% for the PPI. To be sure, oil prices are not expected to rise further. The OPEC target is only \$18 per barrel, close to current oil prices. In addition, OPEC production probably will exceed their targeted amounts by more than a million barrels a day. If this develops, oil prices almost certainly will collapse to the \$13 - \$14 range by the spring. A renewed assault to the \$18 range is not likely until the beginning of the next heating season.

Given the near term acceleration of measured inflation, it is unlikely that the Federal Reserve will pursue more stimulative monetary policy. To be sure, inflationary pressures will be as temporary as the temporary sluggishness in the overall economy. However, the Federal Reserve simply cannot afford to lose credibility in its anti-inflation fighting by engaging in monetary ease during period of price stress.

By the end of winter, oil prices will once again be falling. Price increases could diminish to near zero in some spring months. At the same time, further weakness in construction and only a modest rebound in trade balances will be generating less economic growth than the Federal Reserve probably would be anticipating. Therefore, the likely condition for the Federal Reserve to lower the discount rate will not surface until late March or April. One more discount rate cut is anticipated at that time but the range of interest rate declines will be less than a percentage point. Moreover, a return to higher

inflationary pressures toward the end of 1987 may lead to more fundamental interest rate increases at that time. Most interest rates are expected to be slightly higher at the end of 1987 than when the year began.

Sluggish economic growth, increasing inflationary pressures, and no decline in interest rates does not add up to significant price gains on equity markets. Moreover, the corporate sector will be experiencing a significant tax increase. Many corporations already have been forced to lower their earnings to reflect the loss of investment tax credits for the entire year. Further increases in corporate taxes will continue to restrain corporate earnings early in 1987. Tax changes alone probably will lower after-tax returns by more than \$11 billion. Operating profits less tax liabilities will fall by a lesser amount, but a decline of \$3 - \$4 billion in that measure of corporate earnings also is likely. Sluggish economic growth, increased taxes, increased cost pressures as a result of energy inflation and no decline in interest rates certainly means that equity values must fall early in 1987. As a result, the stock market will be under downward pressures during the winter months but might begin rallying after the tax effects gradually subside and energy inflation once again recedes in the spring. Stock market values still are expected to reach new highs in 1987, but the rate of price appreciation is expected to be less than 10%.

Quarterly Profile of GNP

	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1986 Annual</u>	<u>1987 Annual</u>
Real:	2.8	3.1	1.0	2.5	2.1	1.4	2.6	2.0
Price:	3.6	3.9	3.9	3.1	3.8	3.8	2.8	3.3
Nominal:	6.4	5.9	4.9	5.7	6.0	5.2	5.5	5.4

Monthly Statistical Highlights for December 1986

Payroll employment +202,000; index of hours worked +0.2%; household employment +221,000; civilian unemployment rate 6.9%; personal income +0.4%; savings rate 2.5%; personal consumption +0.5%; retail sales +0.5%; auto sales 10.7 million; housing starts +1.4%; housing permits -1.8%; construction expenditures +0.2%; business inventories +0.3%; orders for durable goods -2.5%; orders for nondefense capital goods -3.6%; industrial production +0.3%; CPI +0.4%; PPI +0.4%; consumption deflator +0.3%; leading indicator +0.2%; real GNP +2.0%; M1 +18.8%; M2 +7.5%.

Monthly Statistical Highlights For January 1987

Payroll employment +166,000; index of hours worked 0.0%; household employment +182,000; civilian unemployment rate 6.9%; personal income +0.2%; savings rate 3.8%; personal consumption -0.3%; retail sales -2.7%; auto sales 9.3 million; housing starts -1.7%; housing permits -2.7%; construction expenditures -0.4%; business inventories +0.3%; orders for durable goods +0.3%; orders for nondefense capital goods -1.7%; industrial production +0.1%; CPI +0.5%; PPI +0.8%; consumption deflator +0.3%; leading indicator +0.2%; real GNP -0.3%; M1 +9.7%; M2 +7.2%.

COMMENTARY

Employment - The work week, which declined in October, surged in November. Thus, a 249,000 increase in payroll employment constituted a much stronger rate of increase in labor market condition than in the previous month. The insured unemployment rate dipped as low as 2.6% early in December but to 2.7% during the survey week. This is still consistent with a slight decline in the unemployment rate. Tight store budgets probably prevented any significant gains in retail employment but gradually improving manufacturing activity was expected to add to employment of goods-producing industries.

Hourly earnings have grown at a surprisingly robust rate in the past two months, although the increase from the previous year is still a low 2.3%. Some of the increasing earnings continue to develop in the service industries. However, wage surveys for 1987 suggest that service wage gains will grow about a half percentage point less than in the previous year.

Personal Income - The absence of a one-time \$5.6 billion annual rate bonus for automobile workers significantly slowed wage and salary gains in November. Further reductions in farm subsidies also caused shrinkage in the gains of personal income. Farm subsidies are expected to remain subdued in December before increasing sharply early in 1987. However, slower employment growth and continuing decreases in interest earnings will lead to relatively sluggish gains in personal income. Taxes are increasing nearly \$5 billion per month. However, changes in the tax brackets in January along with readjusted withholding to reflect reduced tax liabilities for wage earners will result in a significant gain in disposable income. Because the savings rate is at unusually low levels in December, this spurt in disposable income will only bring savings up to the 4% range. Indeed, our projections currently show unusually low savings behavior through most of 1987. This is the result of independently generating income and outlay conditions. More likely, property income will be growing faster than current projections suggest. In addition, outlays may be restrained more than currently projected. However, most of the error restraining savings probably is caused by understating income gains by some unmeasured amount.

Apparently, advertisements asking consumers to get their sales tax deduction and buy an automobile proved to be effective. Auto sales were surprisingly strong during the fall following an unusual surge in sales in the summer months. However, these sales almost certainly are borrowing from the first part of 1987. Therefore, durable goods activity should fall significantly. In addition, some of the strength in non-auto durable sales may have been sales tax-induced, although tax payers must maintain proof of sales tax deductions and not use the tax table in order to benefit from the sales tax consequences of purchasing home entertainment units, furniture, and other large household items. Only the automobile receives a separate sales tax line in the current tax forms. A spurt in sales of services in November appears to reflect a slight rebound in utility purchases and a more significant gain in stock activity. As financial charges are expected to slow in December, growth of service expenditures also should slow. Utility rates should remain relatively subdued through most of 1987, leading to modest gains in services expenditures.

Construction - Although reduced mortgage rates have increased real estate activity for previously-owned homes, causing sales to exceed 3.93 million at annual rates in November, sales of new homes remain sluggish. Inventories are now at 6.6 months of sales, which usually means a slight slowing in single-family

starts. For that reason, projections of starts have been lowered early in 1987. As interest rates are expected to fall during the spring, sales are expected to rebound slightly at that time. Nevertheless, single-family starts probably will average less than 1.1 million in 1987. The sharp increase in housing permits during November remains a surprise. Much of the increase was in multi-family units. However, multi-family starts continued to be lackluster. The looming impact of tax reform also suggests that multi-family starts will continue to weaken. Therefore, the increase in permits during November possibly reflects an attempt to seek financing for rental properties, which may never be built if the financing will not be forthcoming. Multi-family activity is expected to average less than 500,000 units in 1987.

Although the weakening of housing starts will have a modest restraining effect upon residential construction expenditures, most of the construction weakness is expected to occur in nonresidential activity. We continue to project significant declines in nonresidential activity beginning in the first quarter of 1987. However, the Dodge reports show a significant improvement in orders for nonresidential construction during November. This anomalous behavior also cannot be explained. Once again, it may be an attempt by investors to seek financing before the beginning of the new year and may reflect contracts that will not be aggressively pursued in the absence of available financing. Because orders are stronger currently than is consistent with the significant dropoff in nonresidential construction, our projections are showing stronger construction activity early in 1987 than originally anticipated. Nevertheless, weakness is expected to persist through most of the year.

Business Activity - Orders for durable goods surged in November, partially as a result of growing orders for defense goods. Defense orders now are exceeding shipments by more than \$2 billion and almost certainly will come down in the next couple of months. In addition, rapid gains in defense shipments might reflect a hurry up by defense contractors before new accounting changes significantly influence the tax consequences of their business in 1987. Defense shipments should fall off early in 1987 before rebuilding late in the year. Sharp gains in orders for nondefense capital goods apparently reflect attempts to acquire goods before depreciation schedules become less liberal in 1987. Orders should fall off early in 1987 along with shipments. In addition, capacity utilization remains at a level that should not stimulate much capital spending activity. On average, nondefense capital shipments will increase in 1987 but only by the rate of inflation.

Business inventories began accumulating in October as a result of the 7% increase in automobile inventories. Inventory investments almost certainly will be a major contributor to economic activity during the fourth quarter. Manufacturing inventories showed some stability in the past few months and should begin accumulating early in 1987. Sales growth should lead to more substantial inventory response in 1987 than in earlier years, when the high cost of holding inventories dramatically restrained the level of desired inventories. With interest rates down significantly and signs that industrial inflation are gradually intensifying, these inventory costs are gradually diminishing. Nevertheless, no speculative inventory holdings are expected in 1987.

Prices - Changes in automobile sales dramatically influenced the consumer durables deflator in October. This resulted in a much slower rate of increase

for the consumption deflator than for other inflation estimates. Of course, falling energy prices remained a factor on consumer nondurables. At the present time, however, oil prices are rising. Increasing energy prices will lead to CPI gains at annual rates of 6% in January and February and PPI gains at rates approaching 9% in both months. We are than anticipating that inflationary pressures once again will subside in the spring, causing the CPI to grow at relatively modest rates. On a quarterly basis, the CPI is expected to expand at a 5% annual rate during the first quarter and then slow to a 2.5% rate of expansion in the spring. Growth rates approaching 4% are than anticipated for the second half of 1987. Inflation will gradually intensify although no signs of any runaway inflation are in sight.

The implicit construction deflator is expected to intensify slightly during the next few months, although reduced demand for construction product will prevent that inflation indicator from showing significant gains.

Miscellaneous - Thus far, there is little evidence that the trade balances are significantly improving. Preliminary estimates for November show a record trade deficit. Some of that import surge was the result of goods again flowing into ports following work stoppages in October. In addition, the beginning of a 0.22% user fee for imports may have encouraged some traders to bring goods in earlier. Thus, the surge in imports during November clearly is an aberration. On the other hand, oil imports remained at a relatively subdued 223 million barrels in November with a reported price of only \$13.51. With oil prices currently exceeding \$17, a rebound in imports of mineral fuels from a monthly rate of \$3.2 billion to the vicinity of \$4 billion can be anticipated in the next few months. When oil prices fall in the spring, the reduction in imports of mineral fuels will begin to more substantially generate improvements in the trade balances. Nevertheless, the trade improvement will be less than \$20 billion according to our projections. This falls far short of the \$40 billion that the administration and other optimistic forecasts have been expecting.

Some of the surge in the leading indicators for November reflects a continuation of a rebound in sensitive prices from unusually low levels last August. Although some analysts have argued that this rebound suggests more inflationary pressure ahead, it probably only reflects increased industrial activity at the present time. A continuation of rapid price increases for the sensitive price component of the leading indicators could suggest intensifying inflation ahead, but this probably will not develop for a few more months. The leading indicators also were bolstered by orders and shipments that were trying to be completed before tax laws changed in January. For that reason, some of the strength clearly cannot be sustained. As a result, the leading indicators probably will show only limited further rates of expansion in the months ahead. In fact, when building permits and orders begin subsiding late in 1987 and when increasing inflationary pressures sharply reduce the positive contributions from M2, the leading indicators could actually turn down.

Financial Markets

Inventory rebuilding has been a significant factor propping up short-term interest rates in the past few months. Now that corporate taxes are increased because of retroactive requirements in paying for the lapse in investment tax credit, corporate cash flow will be significantly restrained over the next few

months. Although lower withholding rates for wage earners will partially moderate the restraining influences from higher corporate taxes, corporate borrowings for inventory purposes with the reduced cash flow probably will exert upward pressures upon short-term interest rates through the first quarter. In addition, rising energy prices will increase the costs of holding energy inventories.

On the other hand, the government probably will gradually reduce its need for deficit financing as a result of expenditures restraints and one-time benefits from higher corporate taxes. Although government borrowings could be \$45 billion of new cash in the first quarter, borrowings will definitely be in single-digit billions during the spring. Total borrowings for calendar 1987 will be in the vicinity of \$175 billion. While this is substantially higher than contemplated by Gramm-Rudman, it is significantly lower than the \$220 billion borrowed in the previous year. Thus, the government will be exerting less upward pressures upon interest rates in 1987.

Our current projections would suggest a significant upward swing in credit market pressures as a result of diminished household savings late in the year. However, it appears that property income probably is being understated by government statistics. Therefore, the upward impact upon interest rates exerted by reduced household savings has been ignored.

Although the dollar will be falling in value through much of 1987, interest rate differentials should continue to encourage foreign investors to seek American assets. While there is some evidence that foreign investors are shifting their desires from the fixed-income market to American real estate and equity holdings, a sufficient supply of financing from abroad will be available to prevent any significant upsurge in American interest rates during 1987. As mentioned above, interest rates may rise slightly early in 1987 as a result of energy inflation and the inflationary fears generated by a falling dollar. However, economic weakness will become more important again during the spring when energy inflation once again recedes. At that time, a Federal Reserve discount rate cut is expected to materialize. This would lower the prime rate to 7%. Toward the end of the year, however, rising inflationary pressures probably will be exerting upward pressures upon interest rates. Indeed, long-term interest rates are expected to be higher at the end of 1987 than at the present time. Most short-term interest rates will be about the same at yearend as they began the year.

Equity Markets - Increased corporate taxes, possibilities of rising interest rates, and relatively sluggish revenue and profit gains early in 1987 do not bode well for the stock market. A sell off to the 1700 range on the Dow Jones still appears to be possible in the winter months with these events. However, corporate taxes will gradually be dispersed in the form of higher prices where possible or cost constraints. By mid-year, corporate profitability once again will be on the upswing. In addition, consumer sluggishness will have run its course although construction weakness will persist through the remainder of 1987 and into 1988. A further decline in the dollar's value will further improve the opportunities of export-oriented industries and may also increase the profitability, if not the shipments, of import-impacted industries. While increased inflation generated by these price shifts will gradually raise interest rates, corporate profitability is expected to grow even more rapidly. Therefore, the stock market should recover from its early sinking spell and reach new highs toward the end of 1987. Total returns on equity investments may remain in single digits however in 1987.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	100105	100105	117.9	117.9	109882	109882	6.9	6.9	168.9	168.9
August	100261	100283	118.4	118.4	110155	110155	6.8	6.8	169.2	169.3
September	100368	100560	118.4	118.4	109891	109891	7.0	7.0	169.2	169.6
October	100558	100820	118.7	118.7	110169	110240	7.0	7.0	169.9	170.0
November	100713	101069	119.0	119.5	110235	110371	6.9	7.0	170.1	170.7
December	100868	101271*	119.2	119.7*	110278	110592*	7.0	6.9*	170.3	171.1*
January 1987	100993	101437	119.3	119.7	110569	110774	7.0	6.9	170.8	171.5
February	101108	101589	119.3	119.9	110799	110990	7.0	6.9	171.3	171.8
March	101223	101746	119.4	120.1	110990	111171	6.9	6.9	171.9	172.3
April	101462	101923	119.8	120.2	111216	111385	6.8	6.8	172.3	172.8
May	101654	102105	120.0	120.4	111452	111533	6.8	6.9	172.6	173.2
June	101846	102273	120.2	120.6	111688	111759	6.7	6.8	173.0	173.6
July	101993	102428	120.4	120.7	111816	112049	6.6	6.7	173.5	174.0
August	102104	102569	120.5	120.9	111945	112156	6.7	6.8	173.9	174.5
September	102215	102736	120.6	121.0	112074	112275	6.8	6.8	174.4	174.9
October	102420	102903	120.8	121.2	112280	112451	6.8	6.8	174.8	175.4
November	102565	103056	121.0	121.3	112483	112644	6.7	6.8	175.2	175.8
December	102711	103221	121.1	121.5	112687	112849	6.7	6.8	175.6	176.3

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	3.493	3.491	2.072	2.072	110.9	115.0	2.979	2.977	2.868	2.862
August	3.500	3.498	2.083	2.083	95.0	94.1	2.981	2.979	2.886	2.884
September	3.512	3.508	2.090	2.088	56.6	43.1	2.988	2.984	2.889	2.941
October	3.527	3.520	2.101	2.103	104.6	108.0	3.001	2.992	2.897	2.884
November	3.544	3.531	2.108	2.113	116.3	82.4	3.014	2.996	2.898	2.914
December	3.560	3.544*	2.115	2.123*	109.4	75.1*	3.028	3.004*	2.919	2.929*
January 1987	3.564	3.550	2.125	2.129	128.3	114.5	3.057	3.035	2.929	2.921
February	3.577	3.562	2.136	2.138	118.8	117.2	3.066	3.049	2.947	2.932
March	3.592	3.577	2.146	2.149	118.9	116.4	3.078	3.062	2.959	2.946
April	3.613	3.592	2.155	2.159	124.2	113.3	3.097	3.075	2.973	2.962
May	3.632	3.608	2.167	2.169	120.3	103.3	3.113	3.087	2.993	2.984
June	3.652	3.625	2.176	2.180	117.3	101.4	3.130	3.105	3.013	3.004
July	3.664	3.641	2.184	2.188	114.7	96.1	3.138	3.117	3.023	3.021
August	3.676	3.660	2.193	2.200	106.6	94.7	3.146	3.132	3.039	3.037
September	3.689	3.676	2.202	2.208	100.3	86.4	3.154	3.144	3.053	3.058
October	3.709	3.695	2.211	2.220	102.8	89.7	3.170	3.158	3.067	3.068
November	3.728	3.712	2.221	2.228	94.2	82.5	3.185	3.170	3.091	3.088
December	3.748	3.732	2.232	2.240	97.0	82.6	3.201	3.186	3.105	3.103

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	2772.7	2766.7	381.1	385.5	932.8	932.3	1448.9	1448.8	2433.3	2427.9
August	2790.2	2788.6	402.4	402.8	937.2	934.9	1450.6	1450.9	2443.2	2440.0
September	2834.9	2844.0	437.1	455.2	936.5	931.2	1461.3	1457.6	2474.6	2476.2
October	2799.1	2785.4	384.3	381.9	944.3	939.4	1470.5	1464.1	2436.1	2419.6
November	2799.8	2815.0	379.8	386.1	941.7	949.0	1478.3	1479.9	2428.3	2438.0*
December	2820.0	2829.1*	382.5	388.9*	949.6	952.2*	1487.9	1488.0*	2437.3	2444.1
January 1987	2829.3	2819.8	379.6	366.7	954.5	957.4	1495.2	1495.7	2437.0	2426.3
February	2846.6	2830.2	384.1	364.1	958.2	962.2	1504.3	1503.9	2443.4	2427.7
March	2858.2	2843.1	386.5	366.5	957.1	963.8	1514.6	1512.8	2445.0	2432.1
April	2871.1	2858.2	389.4	372.1	958.2	964.3	1523.5	1521.8	2449.7	2439.2
May	2891.1	2879.2	393.6	380.9	964.7	967.7	1532.8	1530.6	2462.6	2450.7
June	2909.9	2898.2	393.3	386.0	976.9	973.2	1539.7	1539.0	2470.2	2458.6
July	2919.6	2914.6	395.2	388.9	975.6	978.4	1548.8	1547.3	2470.1	2465.2
August	2935.2	2930.1	396.8	391.8	980.2	982.2	1558.2	1556.1	2474.9	2469.4
September	2948.7	2949.5	399.6	393.9	980.6	991.3	1568.5	1564.3	2477.9	2477.8
October	2962.1	2959.2	397.8	395.3	986.4	989.7	1577.9	1574.2	2480.8	2477.8
November	2984.8	2977.5	405.3	397.9	993.1	995.2	1586.4	1584.4	2491.5	2486.0
December	2998.5	2992.6	404.7	400.7	998.0	998.8	1595.8	1593.1	2494.6	2489.8

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	119.80	119.80	18.80	18.88	10.7	10.7	73.49	73.49	27.43	27.43
August	121.57	121.52	19.13	19.14	12.7	12.7	73.88	73.61	28.57	28.77
September	127.18	128.33	19.22	19.30	16.1	16.1	73.83	73.71	34.13	35.32
October	121.34	121.62	19.15	19.29	10.3	10.3	74.43	74.03	27.76	28.29
November	120.18	122.25	19.53	19.62	9.5	10.5	74.22	74.53	26.43	28.11
December	121.54	122.85*	19.71	19.64*	9.8	10.7*	74.85	74.78*	26.98	28.43*
January 1987	121.16	119.52	19.61	19.46	9.4	9.3	75.23	75.19	26.32	25.87
February	122.00	120.58	19.64	19.43	9.6	9.0	75.52	75.57	26.84	25.58
March	122.21	121.00	19.62	19.50	9.9	9.2	75.44	75.69	27.15	25.81
April	122.64	121.73	19.79	19.56	10.0	9.7	75.52	75.73	27.33	26.44
May	123.67	123.09	19.99	19.61	10.2	9.9	76.04	76.00	27.64	27.48
June	124.59	124.15	20.07	19.68	10.1	10.2	77.00	76.43	27.52	28.04
July	124.71	124.91	20.06	19.81	10.2	10.3	76.89	76.84	27.76	28.26
August	125.28	125.57	20.08	19.89	10.3	10.4	77.26	77.14	27.94	28.54
September	125.45	126.54	20.13	20.03	10.3	10.4	77.29	77.85	28.03	28.66
October	125.89	126.60	20.26	20.06	10.2	10.3	77.75	77.73	27.88	28.81
November	127.31	127.35	19.99	19.90	10.6	10.5	78.27	78.16	29.05	29.29
December	127.63	127.98	20.03	20.02	10.5	10.6	78.66	78.44	28.94	29.52

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	1.782	1.782	1.137	1.137	1.759	1.759	378.1	376.6	335.2	333.8
August	1.818	1.795	1.199	1.186	1.673	1.673	382.2	381.4	338.1	337.4
September	1.580	1.664	1.116	1.102	1.613	1.603	382.8	380.3	338.2	335.5
October	1.694	1.628	1.133	1.090	1.592	1.565	384.3	386.5	338.6	341.1
November	1.687	1.598	1.143	1.093	1.576	1.592	385.5	385.3	338.8	339.2*
December	1.680	1.620*	1.141	1.108*	1.583	1.564*	385.9	386.2*	338.2	339.4
January 1987	1.713	1.593	1.152	1.086	1.567	1.522	383.3	384.7	335.1	337.5
February	1.698	1.588	1.150	1.092	1.569	1.497	380.7	383.4	332.2	335.7
March	1.685	1.574	1.136	1.075	1.543	1.483	378.7	382.4	329.6	333.4
April	1.637	1.595	1.121	1.084	1.517	1.486	379.8	380.3	329.7	331.6
May	1.625	1.590	1.115	1.103	1.483	1.473	379.7	380.3	328.7	330.7
June	1.612	1.577	1.112	1.074	1.472	1.462	379.5	379.8	327.7	329.7
July	1.615	1.588	1.120	1.082	1.470	1.467	377.8	379.5	325.7	328.9
August	1.607	1.632	1.117	1.121	1.463	1.513	376.5	378.5	324.3	327.7
September	1.600	1.625	1.099	1.116	1.438	1.526	375.7	380.1	323.0	328.5
October	1.597	1.587	1.087	1.095	1.445	1.507	376.5	379.9	322.9	327.5
November	1.593	1.573	1.084	1.069	1.452	1.492	377.9	379.5	323.3	326.6
December	1.588	1.574	1.080	1.083	1.455	1.481	379.1	378.1	323.2	324.5

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	129.8	129.9	72.5	72.4	175.9	174.3
August	131.9	132.3	73.6	72.5	176.7	176.5
September	132.2	130.5	73.5	73.3	177.1	176.4
October	132.0	134.1	74.3	73.7	178.0	178.7
November	131.7	133.7*	75.2	74.3*	178.6	177.3*
December	131.2	134.3	76.1	74.6	178.6	177.3
January 1987	130.9	133.6	75.5	74.3	176.9	176.8
February	130.6	132.5	75.1	74.5	175.0	176.4
March	130.4	131.6	75.3	74.9	173.0	175.9
April	130.8	129.8	75.4	75.2	173.6	174.5
May	131.1	129.9	75.6	75.3	173.0	175.1
June	131.2	129.2	75.6	75.7	172.7	174.9
July	130.9	128.5	76.1	76.2	170.8	174.8
August	130.6	128.3	76.6	76.1	169.3	174.1
September	131.0	128.0	77.0	76.7	167.7	175.4
October	131.1	127.4	77.2	77.1	168.2	175.4
November	131.4	127.6	77.6	77.4	168.9	174.5
December	131.6	127.5	78.0	77.8	169.5	172.8

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	278.6	278.6	106.22	106.22	27.39	27.39	27.42	27.42
August	278.1	277.5	103.85	103.85	26.33	26.33	27.28	27.28
September	277.8	276.6	108.99	108.72	28.63	28.22	27.22	27.08
October	278.1	276.2	104.63	103.57	27.42	26.91	27.36	27.72
November	278.5	276.5	104.28	109.68	27.05	28.78	27.21	28.07
December	279.0	277.0*	102.89	106.94*	26.43	27.74*	27.13	28.56*
January 1987	279.8	277.4	103.17	107.23	26.46	27.26	27.19	27.72
February	280.7	278.0	104.93	107.46	26.82	27.35	27.10	27.65
March	281.6	278.8	104.86	106.88	26.95	27.52	27.15	27.76
April	282.9	279.4	106.07	108.22	27.46	27.91	27.39	27.89
May	283.5	280.2	106.89	107.63	27.89	27.46	27.67	27.83
June	284.2	280.9	106.55	108.12	27.90	27.84	27.91	27.94
July	285.7	281.8	105.93	107.83	27.51	28.11	27.84	28.11
August	286.5	282.6	105.46	107.54	27.36	28.04	27.56	28.26
September	287.6	283.5	105.67	106.27	27.45	27.69	27.79	28.15
October	289.0	284.4	106.29	106.49	27.82	27.84	27.85	28.31
November	290.1	285.3	107.43	106.65	27.99	27.93	28.01	28.44
December	291.1	286.3	108.21	106.92	28.13	28.07	28.16	28.49

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	591.9	591.9	8.08	8.08	124.9	124.9	79.3	79.2
August	591.9	590.1	7.64	7.64	125.1	125.1	79.2	79.2
September	590.2	588.1	7.67	7.69	125.3	125.1	79.2	79.1
October	591.5	591.3	7.92	8.01	125.5	125.2	79.1	79.0
November	593.6	593.1*	8.05	8.69	125.6	125.9	79.0	79.3
December	595.9	594.8	8.18	8.43*	125.7	126.3*	78.9	79.4*
January 1987	597.8	596.4	8.21	8.50	125.9	126.5	78.9	79.4
February	599.4	597.8	8.15	8.52	126.0	126.7	78.8	79.3
March	602.3	600.0	8.26	8.56	126.2	126.8	78.8	79.2
April	604.6	601.3	8.30	8.60	126.8	126.9	79.2	79.1
May	606.9	603.6	8.34	8.57	127.4	127.1	79.6	79.1
June	608.7	605.1	8.38	8.64	128.0	127.3	80.0	79.1
July	611.5	607.5	8.46	8.70	128.0	127.5	79.8	79.0
August	613.4	609.3	8.57	8.57	128.0	127.6	79.6	79.0
September	615.7	612.4	8.69	8.65	127.9	127.6	79.3	78.9
October	618.0	613.6	8.42	8.93	127.7	127.8	78.9	78.9
November	619.9	616.0	8.65	9.07	127.7	128.0	78.7	78.9
December	622.6	618.1	9.03	8.94	127.9	128.2	78.7	78.9

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	PPI							
	CPI-U		Finished Goods		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		(seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	327.6	327.6	287.3	287.3	308.5	308.5	114.7	114.7
August	328.2	328.2	288.3	288.2	307.7	307.7	114.9	114.9
September	329.2	329.3	289.5	289.3	308.8	308.8	115.3	115.3
October	330.3	329.8	290.4	290.3	310.0	309.3	115.6	115.5
November	331.1	331.0	291.0	290.7	310.5	309.6	115.9	115.9
December	332.0	332.3*	292.0	291.9*	311.1	310.4*	116.3	116.1*
January 1987	333.2	333.6	293.1	293.8	311.7	312.7	116.7	116.6
February	334.4	335.0	294.2	294.5	312.2	314.0	117.1	116.9
March	335.5	335.9	295.0	295.0	312.4	314.5	117.3	117.3
April	336.5	336.5	295.8	295.6	313.0	314.0	117.6	117.5
May	337.4	337.3	296.6	296.3	313.3	314.4	118.0	117.8
June	338.3	338.3	297.4	297.1	313.6	315.0	118.3	118.2
July	339.3	339.2	298.1	297.9	313.9	315.3	118.6	118.5
August	340.2	340.1	298.9	298.7	313.3	315.6	119.0	118.9
September	341.1	341.1	299.6	299.5	311.2	313.4	119.4	119.3
October	342.2	342.2	300.6	300.4	314.3	316.1	119.8	119.7
November	343.3	343.2	301.6	301.5	315.1	316.6	120.1	120.0
December	344.4	344.4	302.5	302.4	315.9	317.4	120.4	120.4

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	113.9	114.0	105.5	105.3	106.1	106.1	122.4	122.5	112.8	112.8
August	114.2	114.3	105.8	105.7	106.4	106.4	122.8	122.9	113.0	113.0
September	114.5	114.9	106.3	106.5	106.7	107.1	123.2	123.8	113.1	113.3
October	114.9	115.1	106.5	105.3	106.9	107.1	123.7	124.1	113.5	113.3
November	115.3	115.5*	106.3	105.6*	107.1	107.5*	124.1	124.4*	113.8	113.6*
December	115.7	115.8	106.2	105.8	107.5	107.8	124.5	124.7	114.1	113.8
January 1987	116.1	116.2	106.5	105.5	107.9	108.3	125.0	125.2	114.4	114.0
February	116.5	116.6	106.7	105.5	108.1	108.7	125.5	125.6	114.6	114.2
March	116.9	116.9	106.9	105.8	108.2	108.9	126.0	126.0	114.9	114.5
April	117.2	117.2	107.1	106.4	108.5	108.9	126.4	126.4	115.2	114.7
May	117.4	117.5	107.3	106.8	108.8	109.1	127.0	126.8	115.5	115.0
June	117.8	117.9	107.5	107.2	109.1	109.4	127.5	127.3	115.8	115.2
July	118.2	118.2	107.6	107.5	109.3	109.6	128.1	127.8	116.0	115.4
August	118.6	118.7	107.8	107.7	109.5	109.9	128.6	128.4	116.1	115.5
September	119.0	119.0	108.0	108.0	109.8	110.2	128.9	128.9	116.3	115.7
October	119.4	119.4	108.2	108.4	110.2	110.5	129.4	129.3	116.6	116.0
November	119.8	119.8	108.4	108.6	110.6	110.7	130.0	129.8	116.9	116.2
December	120.2	120.2	108.6	108.8	111.0	111.0	130.6	130.4	117.3	116.5

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	-16.06	-16.06	179.4	179.4	4210	4220	3670	3678	9.4	9.4
August	-13.32	-14.04	179.1	179.1	4233	4240	3684	3689	13.6	13.6
September	-16.67	-14.74	179.3	179.5	4260	4260	3695	3695	-4.1	-2.0
October	-15.62	-14.71	179.8	180.4	4276	4279	3699	3705	-6.7	-1.3
November	-15.29	-19.22p	179.9	182.5	4289	4308	3701	3717	-11.3	-5.2
December	-14.84	-14.53*	179.6	182.8*	4305	4322	3702	3723	-13.5	-7.4
January 1987	-15.29	-13.65	179.3	183.2	4323	4338	3704	3720	-11.6	-12.3
February	-15.07	-13.91	179.4	183.1	4347	4352	3712	3723	-10.8	-10.5
March	-14.85	-13.43	179.7	182.5	4370	4375	3725	3730	-9.9	-5.3
April	-14.63	-12.64	180.0	183.4	4398	4395	3740	3740	-8.9	-2.6
May	-14.41	-12.85	180.2	182.9	4426	4417	3751	3749	-7.3	-1.9
June	-14.18	-13.46	179.8	183.3	4454	4436	3765	3753	-6.7	-4.3
July	-15.86	-14.58	179.5	182.5	4467	4461	3766	3764	-1.2	-5.7
August	-15.27	-13.65	179.7	182.1	4480	4478	3765	3766	-1.3	-7.2
September	-14.68	-13.49	180.2	181.5	4492	4499	3762	3771	-5.0	-9.1
October	-14.72	-13.16	180.6	181.6	4517	4518	3770	3774	-9.9	-8.5
November	-14.64	-12.88	180.9	181.5	4536	4539	3777	3783	-15.6	-9.6
December	-14.56	-12.85	181.3	181.8	4556	4553	3784	3782	-19.9	-10.2

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	245.5	245.7	676.1	676.0	2699.1	2699.2	6.56	6.56	5.86	5.86
August	246.8	247.7	687.8	687.6	2723.8	2724.3	6.17	6.17	5.55	5.55
September	248.6	248.7	693.3	693.1	2740.6	2740.8	5.89	5.89	5.35	5.35
October	250.5	250.8	701.8	701.2	2758.4	2764.9	5.83	5.85	5.30	5.26
November	252.9	252.1	707.3	713.4	2773.5	2780.1	5.76	6.04	5.20	5.41
December	255.3	254.5*	712.8	723.7*	2788.2	2796.8*	5.68	6.21*	5.16	5.58*
January 1987	256.4	255.9	719.2	729.3	2804.6	2813.1	5.37	5.83	4.91	5.42
February	257.3	257.1	723.0	733.2	2822.5	2832.3	5.20	5.76	4.95	5.27
March	258.3	258.4	727.8	736.4	2840.8	2848.8	5.16	5.59	4.99	5.13
April	260.1	259.8	732.9	741.7	2859.3	2868.2	5.22	5.36	5.02	5.05
May	262.0	261.3	736.5	747.1	2876.9	2887.8	5.27	5.28	5.03	5.09
June	263.9	262.7	740.1	752.1	2894.5	2909.1	5.33	5.33	5.05	5.13
July	265.2	264.3	744.3	757.2	2910.6	2926.6	5.50	5.39	5.30	5.20
August	266.7	266.0	747.6	762.4	2923.9	2945.9	5.56	5.43	5.34	5.27
September	268.3	267.8	750.9	768.3	2937.2	2966.5	5.62	5.68	5.38	5.41
October	269.9	269.4	756.0	773.7	2956.1	2987.3	5.65	5.78	5.30	5.45
November	271.2	271.1	762.1	779.4	2974.5	3005.2	5.69	5.86	5.26	5.43
December	273.5	272.9	768.1	785.9	2992.8	3021.7	5.73	5.94	5.22	5.54

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	8.88	8.88	7.51	7.51	6.33	6.33	6.37	6.37	8.16	8.16
August	8.72	8.72	7.21	7.21	5.92	5.92	5.92	5.92	7.90	7.90
September	8.89	8.89	7.11	7.11	5.68	5.68	5.71	5.71	7.50	7.50
October	8.93	8.86	7.06	7.08	5.73	5.68	5.75	5.69	7.50	7.50
November	8.76	8.68	6.89	6.85	5.70	5.76	5.72	5.76	7.50	7.50
December	8.53	8.69*	6.65	6.97*	5.64	6.23*	5.67	6.15*	7.50	7.50*
January 1987	8.56	8.86	6.68	7.11	5.30	5.86	5.26	5.92	7.39	7.50
February	8.50	8.72	6.61	6.98	5.17	5.85	5.15	5.89	7.00	7.50
March	8.60	8.53	6.71	6.81	5.12	5.54	5.12	5.60	7.00	7.50
April	8.65	8.41	6.76	6.69	5.17	5.28	5.20	5.37	7.00	7.34
May	8.57	8.36	6.69	6.60	5.26	5.19	5.33	5.30	7.00	7.00
June	8.62	8.43	6.75	6.67	5.35	5.25	5.41	5.32	7.00	7.00
July	8.97	8.59	7.23	6.87	5.63	5.36	5.69	5.43	7.08	7.00
August	9.20	8.71	7.44	7.06	5.68	5.48	5.80	5.56	7.50	7.00
September	9.22	8.84	7.47	7.21	5.70	5.72	5.84	5.85	7.50	7.38
October	8.99	8.92	7.24	7.30	5.73	5.83	5.86	6.01	7.50	7.50
November	8.90	8.90	7.14	7.30	5.75	5.95	5.89	6.06	7.50	7.50
December	8.87	9.01	7.10	7.40	5.72	6.07	5.85	6.14	7.50	7.68

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

3/12/87 U1880-3

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MONTHLY PROJECTIONS January 1987

Dr. Donald Ratajczak, Director
For Release: January 29, 1987

PLUNGING DOLLAR CHANGES INFLATION AND GROWTH PROSPECTS

Dollar declines were anticipated in 1987 as a result of the large current account deficit projected for the year. In effect, foreign investors would be required to absorb \$150 billion of American assets. While their demand for dollar assets remains strong, such an absorption without further dollar value concessions appeared to be unlikely. Furthermore, although trade flows are beginning to change with increasing American exports and diminished non-oil imports, the oil component of imports continues to rise. Both a reduction in domestic oil production and an increase in the dollar value of oil imports assures rising oil imports for the foreseeable future. As a result, the current account deficit is not expected to diminish significantly in 1987.

At the same time, sluggish economic activity in the United States continues to force interest rates downward. This has been reducing the interest rate gap between assets in the United States and assets abroad. Thus, even as foreign investors are being called upon to absorb more American assets, the relative attractiveness of those assets is diminishing. Indeed, our November forecast suggested that the trade-weighted value of the dollar would fall below 100 on a 1973 base, but the decline was not expected to be as rapidly as has materialized. In the month of January, the German currency has appreciated 7.7% against the U.S. dollar. The yen is 4.9% higher while the British pound is 4.1% higher. To be sure, the dollar's decline has been less than 1% against the Taiwan dollar and less than one-half percent against the South Korean won. As a result, the impact of the dollar's decline upon trade flows remains uneven. Nevertheless, the dollar's early and substantial weakness at the beginning of 1987 alters the expected economic environment for the year.

First, the dollar's further decline almost certainly is responsible for much of the increase in raw material prices that has developed in recent weeks. Although the Journal of Commerce index of raw materials has stabilized in the past week, it has been growing at a 12% annual rate during the past three months. Prices of nonenergy crude materials other than foodstuffs also have

been increasing about 1% per month. These increasing prices soon should spill over into more general industrial materials and lead to increasing commodity price inflation. Indeed, American corporations once again began earning profits on the price appreciation of their inventories in the fourth quarter. As a result, inflationary pressures during the latter half of 1987 may be more vigorous than projected earlier. Inflation could begin exceeding a 4% growth path even before 1987 comes to an end.

Second, rising commodity inflation will begin to encourage inventory investments. Most of the inventory liquidations in manufacturing were caused by high carrying costs for inventories. Not only did purchasers need to finance the inventories, but prices generally were falling earlier in 1986. As a result, inventories actually suffered reduced prices while they were waiting to be used. Now that modest commodity inflation has reappeared, increasing inventory investments are likely. This will add to economic growth, especially in the latter part of 1987, but it will also begin exerting upward pressures upon short-term interest rates.

Third, the more dramatic decline in the dollar's value than expected earlier will intensify the development of favorable trade flows. Exports should grow more intensely, possibly increasing by as much as 8% in 1987 after adjustment for inflation. However, export gains will continue to be restrained by weakness in foreign markets. In addition, the volume of imports probably will slow slightly. However, increased inventory investments in the United States will prevent any significant deterioration in commodities flowing into the United States. Trade deficits will shrink, but the magnitude of their decline will only marginally exceed the increase in earnings by foreign investors from their American assets. Therefore, the current account deficit will continue to shrink only modestly.

How much farther the dollar will fall remains difficult to determine. On a purchasing power parity basis, the dollar's decline against most European currencies appears to be sufficient to once again establish the United States as a low-cost producer. In the Pacific, however, the dollar could fall as much as 30% further against the Japanese yen before purchasing power parity is restored. Even greater declines would be necessary against other Pacific currencies, as they have barely adjusted to the dollar's weakness.

However, such purchasing power parity measurements merely show neutrality in trade flows at equilibrium. They do not indicate the degree to which trade flows must favor the United States if foreign investors become satiated with dollar-based assets. Those investors are becoming less willing to acquire American assets without further currency concessions. We are currently projecting that the German mark will not stabilize before reaching 1.7 to the dollar and that the yen will fall to 140 before stability develops.

Even before currency equilibrium is established, foreign investors will be seeking American real estate and equity ownership. While they could wait until the falling dollar further increases the attractiveness of American assets, the rising American stock market suggests that such delays are not helpful. However, bond investments may be delayed until interest rate yields rise sufficiently in the United States to offset prospects of further dollar devaluation. Thus, interest rates should rise modestly while the currency adjustment continues to evolve.

In fact, weakness in the currency markets explains why the stock market has performed so favorably in January without any supporting role from the bond market. Interest rates are higher today than they were at the beginning of the year. Yet, this is exactly what should be expected as a falling dollar increases the attractiveness of real assets in the United States while decreasing the attractiveness of financial instruments until yields have widened sufficiently to offset the currency risk that new investors will face.

Quarterly Profile of GNP

	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1986 Annual</u>	<u>1987 Annual</u>
Real:	1.7	1.7	2.1	1.8	1.9	2.5	1.9
Price:	1.0	3.5	3.8	3.8	4.1	2.7	3.1
Nominal:	2.6	5.5	5.6	5.8	6.0	5.3	5.1

Monthly Statistical Highlights for January 1987

Payroll employment +208,000; index of hours worked +0.2%; household employment +220,000; civilian unemployment rate 6.7%; personal income +0.1%; savings rate 4.3%; personal consumption -1.5%; retail sales -4.3%; auto sales 8.8 million units; housing starts -11.3%; housing permits -24.7%; construction expenditures -1.2%; business inventories +0.3%; orders for durable goods -0.3%; orders for nondefense capital goods -1.9%; industrial production +0.2%; CPI +0.5%; PPI +0.3%; consumption deflator +0.3%; leading indicators -0.3%; real GNP -0.6%; M1 +9.4%; M2 +8.7%.

Monthly Statistical Highlights for February 1987

Payroll employment +203,000; index of hours worked 0.2%; household employment +217,000; civilian unemployment rate 6.7%; personal income +0.4%; savings rate 4.1%; personal consumption +0.7%; retail sales +0.9%; auto sales 9.3 million units; housing starts +2.3%; housing permits +2.2%; construction expenditures -0.1%; business inventories +0.5%; orders for durable goods +0.5%; orders for nondefense capital goods +0.2%; industrial production +0.2%; CPI +0.5%; PPI +0.8%; consumption deflator +0.4%; leading indicators -0.2%; real GNP +4.6%; M1 +6.7%; M2 +7.0%.

Commentary

Employment - On the surface, the dip in hours worked in December appears to be ominous. However, most of that weakness was caused by very cautious hiring in the trade sector. A rebound in hours in that sector is anticipated in January. Manufacturing payrolls expanded 31,000 while the manufacturing workweek also increased.

The hourly earnings index declined slightly in December and is now only 1.8% above previous year levels. This continues to show no increase in wage inflation at the present time. Despite the decline in hours, the diffusion index was more than 61% showing employment gains, suggesting a broad based and healthy expansion in employment prospects.

Personal Income and Outlays - Personal income was dramatically distorted by a \$20 billion increase in farm subsidies during December. Excluding the subsidies, personal income would have increased only 0.2%. In January, personal income will again have several unusual factors. While farm subsidies will remain high, they probably will decline slightly from December's levels. Increasing social security tax bases will be reflected in higher social security accruals in January, reducing personal income by more than \$3 billion. Also, changes in tax brackets to reflect inflation along with withholding adjustments for individuals to reflect new tax provisions should significantly increase disposable income and reduce tax liabilities. Of course, most of these adjustments will be on an accrual basis and will not significantly alter the liquidity of households until later in the year. Therefore, the statistical surge in disposable income will have relatively modest effect upon consumer outlays.

Outlays themselves will be significantly restrained by a dramatic slowing in automobile sales. Apparently, loss of sales tax deductability caused a shifting of more than 250,000 cars from 1987 purchases to purchases in December 1986. The result will be relatively sluggish automobile sales early in 1987. During the first 20 days of January, sales have been running at an estimated 8.7 million units. Obviously, this reversal will significantly lower retail sales and consumer outlays. Consumer outlays should be increased by higher utility charges in January and also by higher purchases of imputed financial services. Indeed, the less than \$3 billion increase in service expenditures during December reflects a lull in stock market activity and under utilization of utilities because of a relatively mild December. Some tax sales shifting probably occurred in nonauto durables, although the impact there should be relatively light. Unlike the automobile sales tax benefit, which is a separate line on the sales tax deduction form for 1986 income, those benefitting from sales tax deductions on other large ticket items would need to enumerate their sales tax rather than use tax tables. Such enumeration is done by less than 10% of all taxpayers.

Construction - Mild winter weather also was readily apparent in housing starts for December. Activity increased dramatically in the midwest and northeast where winter weather was delayed. Relatively modest housing increases were reflected in the south and west, where weather problems are less important in December. A return to more normal winter weather should significantly reduce housing starts in January. In addition, a surge in housing permits was largely the result of a change in California fees after January 1. As a result, many builders took out their winter permits in December. This surge in permits will, unfortunately, distort the leading indicators, causing them to rise much more dramatically than fundamentals suggest. In January, permits then should fall sharply.

In general, our estimates of single-family starts have been reduced for 1987 as a result of relatively sluggish single-family sales. This sales resistance appears to be related to prices of single-family homes and may also reflect less favorable demographics than had been expected. Mortgage rates, on the other hand, are expected to be slightly lower in 1987 than in our earlier forecasts.

Revisions in construction spending show that nonresidential spending has been trending downward since August. This weakness in nonresidential construction is expected to intensify in the early months of 1987 before leveling out toward the end of the year. On the other hand, temporary weakness in public construction is expected to be reversed once the tax-exempt markets absorb the

impact of changing tax laws. Construction inflation has remained subdued since July, but is expected to trend upward in 1987. Most of the increase in construction costs will be reflected in gradually intensified wage pressures rather than any significant price increases for materials. We are currently projecting a 5.2% decline in inflation adjusted construction expenditures during the twelve months of 1987.

Business Activity - Business inventories showed surprising liquidation in November despite relatively weak automobile sales during that month. The dramatic surge in automobile sales in December assures a significant decline in inventories during that month. Indeed, reduced inventory investment has been one of the factors leading to lower estimates of economic activity during the fourth quarter. Orders were surprisingly strong in November, but they apparently were trying to attract shipments before the beginning of the new year. According to the old tax codes, equipment followed a half-year depreciation cycle. As a result, if 40% of all equipment was put into service in December, that equipment still would receive six months of depreciation. Depreciation now is on a mid-quarter basis, which sharply reduces the tendency to acquire shipments at the end of the year. Nevertheless, distorted orders and shipments probably were instigated by the tax codes in November and December. As a result, durable goods activity should slow significantly early in 1987.

It should be noted that inventory profits again materialized during the fourth quarter, as anticipated. Most of these inventory gains are in the energy component as a result of increasing oil prices. However, other commodity prices also are beginning to rise. Typically, a swing to a negative IVA leads to intensifying inventory accumulations. Such accumulations have not yet been included in our analysis.

Industrial production continues to show little relationship to GNP measures of goods production in any given quarter. Although industrial production rose sharply in the fourth quarter, goods production showed only modest gains. Apparently, increasing distortions on a quarterly basis are developing for the industrial productions index, but the source of these distortions is not readily apparent.

Prices - Because of shifts in automobile sales, there will be dramatic shifts in the consumer durables deflator. In addition to these composition shifts caused by automobile sales, the unusually low GNP deflator for the fourth quarter appears to be the result of the inability of the GNP accounts to effectively capture the impact of import prices in the quarter in which such price increases occur. Because prices of imports accelerated during the fourth quarter, the GNP deflator was reduced. As import prices begin moderating, the deflator probably will accelerate. This unfortunate pattern of price movements is the result of the use of the PPI, which is a domestic-based deflator, for most of the investment components of the GNP index. As a result, imported goods which are inventoried, and not yet registered in consumer spending, will not have their import prices fully neutralized. With accelerating import prices continuing in the first quarter, the GNP deflator again should be restrained. In later quarters, the deflator probably will accelerate even if consumer and producer prices begin moderating.

In fact, consumer and producer prices probably will surge during the winter as a result of higher oil prices and then moderate in the spring. Oil prices may decline significantly during the spring as reduced seasonal demand for oil

will create substantial compliance pressures for the OPEC nations. If that develops, some price changes during the second quarter could be minimal. Nevertheless, more substantial inflation probably will develop during the second half of 1987.

Miscellaneous - As mentioned above, the leading indicators will be biased upward in December because of a surge in building permits. These permits then will decline early in 1987, causing the index to be biased downward. A better reading of the impact of the leading indicators probably can be determined by calculating the index excluding the building permits for the months of December, January and February.

Financial Markets

An acceleration in the monetary base tends to indicate that the Federal Reserve has, indeed, increased support for money growth in December and January. Some of this increased support spilled over into M1 growth and also into growth of other monetary aggregates. However, weakness in the response of expenditures to this increased availability of liquidity has caused the increased monetary accommodation to spill over into foreign exchange and financial markets.

However, the Federal Reserve's increased accommodation appears to be the result of responding to unusual year-end technical demands for liquidity rather than a significant shift in policy. Central banks worldwide were much more aggressive in seeking short-term American assets at the end of the year than in previous years. The result was a dramatic increase in federal funds rates and a sympathetic rise in other sensitive short-term rates. These technical pressures have now dissipated and the Federal Reserve must confront an excess money supply that has been absorbed through sharply accelerating equity values and sharply depreciating dollar values. The Federal Reserve appears to be aware that excessive accommodation of technical conditions has occurred and is trying to restrain further money growth. This explains why short-term interest rates currently are substantially higher than had been projected in our forecast despite relatively weak economic growth.

Fortunately, the financial markets view this increase in money availability as a temporary phenomenon. As a result, the long end of the market has not significantly responded to higher short-term interest rates. Unfortunately, increased money accommodation is now generating increased money demand. The demand is being generated by increased inventory investments, partially spawned by potential for inventory profits. This potential for inventory profits, in turn, appears to be the result of falling currency values. Therefore, the Federal Reserve probably will face some difficulty in restraining monetary aggregates and upward pressures upon short-term rates and inflation.

Weakness in economic activity still is expected during the second quarter along with slowing in inflationary pressures as oil prices recede. If our assumptions about oil prices are incorrect, no downward pressures upon interest rates may materialize. However, assuming oil prices will decline and inventory pressures will begin subsiding, pressures upon the dollar will gradually ease early in the spring. This will then provide some leeway for the Federal Reserve to encourage lower interest rates. However, this decline in rates is expected to be relatively short-lived. Economic activity once again should begin increasing late in the year, leading to intensifying interest rate pressures. In addition, moderation in oil inflation itself is expected to be temporary.

Although optimism still is substantial in the bond markets, it appears more likely that interest rates will not fall as far as we currently project than that any significant further decline in interest rates will develop. As the Federal Reserve already has increased its accommodation, further Federal Reserve accommodation to ensure declining short-term interest rates is not likely. Only if money demand begins receding can further declines in interest rates be anticipated. Yet, economic conditions for reduced money demand are gradually diminishing. Although the economy will not be vigorous, inflationary pressures will intensify and some increasing inventory accumulations based upon rising commodity prices could begin to surface.

Equity Markets - Although a little inflation may be the equivalent of being a little bit pregnant, equity markets normally respond favorably to initial inflationary pressures. Normally, interest rates and wages continue to be motivated by previous inflationary experience while any pickup in the inflationary environment leads to growing profit margins and substantial gains in corporate profitability. That appears to be the economic environment that currently prevails in early 1987. As a result, corporate profits could increase 20% as measured by after-tax profits. A substantial portion of these profit gains will be the result of inventory profits and cannot be sustained. Normally, stock market values will ignore temporary gains in inventory profitability. However, at the beginning phases of accelerating inflation, the stock market tends to accept reported profits as sustainable profits. This permits equity values to rise 10% to 15% more than can be sustained by underlying economic conditions. This appears to be what is happening in the current equity markets. In other words, equity values currently are being dictated by predictions of changes in after-tax earnings rather than by changes in operating profits less tax liabilities (the equilibrium profit condition that ultimately dictates equity values). As after-tax profits are expected to rise sharply in the first half of 1987, equity values also can rise sharply. Unfortunately, when higher inflation begins to increase interest rates and wage pressures, possibly toward the end of 1987, the party's over. At that time, the stock market will experience a significant correction.

In the meantime, we are changing our formulas to suggest that equity values will depend upon changes in after-tax profitability. While this assumes "profit illusion", such illusion appears to be normal at this stage of an inflationary cycle. Under such circumstances, the Dow Jones could rise to the vicinity of 2300 during the spring. A movement to the 2500 level cannot be totally ruled out. However, this will create more than a 15% gap between stock market values and sustainable earnings estimates. Thus, a 15% correction in the market from those levels should be anticipated in the second half of the year.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	100105	100105	117.9	117.9	109882	109882	6.9	6.9	168.9	168.9
August	100261	100283	118.4	118.4	110155	110067	6.8	6.8	169.2	169.3
September	100368	100560	118.4	118.3	109891	109987	7.0	7.0	169.2	169.6
October	100558	100826	118.7	118.6	110169	110192	7.0	6.9	169.9	170.0
November	100713	101065	119.0	119.3	110235	110432	6.9	6.9	170.1	170.9
December	100868	101334	119.2	119.0	110278	110637	7.0	6.7	170.3	170.8
January 1987	100993	101542*	119.3	119.3*	110569	110857*	7.0	6.7*	170.8	171.2*
February	101108	101745	119.3	119.5	110799	111074	7.0	6.7	171.3	171.5
March	101223	101874	119.4	119.6	110990	111248	6.9	6.7	171.9	171.9
April	101462	102044	119.8	119.8	111216	111457	6.8	6.7	172.3	172.4
May	101654	102241	120.0	120.0	111452	111697	6.8	6.6	172.6	172.7
June	101846	102343	120.2	120.1	111688	112084	6.7	6.5	173.0	173.1
July	101993	102455	120.4	120.2	111816	112198	6.6	6.5	173.5	173.5
August	102104	102599	120.5	120.4	111945	112382	6.7	6.5	173.9	173.9
September	102215	102796	120.6	120.6	112074	112251	6.8	6.7	174.4	174.4
October	102420	102984	120.8	120.8	112280	112477	6.8	6.7	174.8	174.8
November	102565	103172	121.0	121.0	112483	112675	6.7	6.7	175.2	175.2
December	102711	103284	121.1	121.1	112687	112771	6.7	6.8	175.6	175.6

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	3.493	3.491	2.072	2.072	110.9	115.0	2.979	2.977	2.868	2.862
August	3.500	3.498	2.083	2.083	95.0	94.1	2.981	2.979	2.886	2.884
September	3.512	3.508	2.090	2.088	56.6	43.1	2.988	2.984	2.889	2.941
October	3.527	3.519	2.101	2.102	104.6	102.8	3.001	2.991	2.897	2.888
November	3.544	3.527	2.108	2.112	116.3	88.2	3.014	2.994	2.898	2.905
December	3.560	3.555	2.115	2.119	109.4	55.7	3.028	3.019	2.919	2.963
January 1987	3.564	3.560*	2.125	2.130*	128.3	130.9*	3.057	3.053*	2.929	2.922*
February	3.577	3.575	2.136	2.139	118.8	126.5	3.066	3.070	2.947	2.944
March	3.592	3.587	2.146	2.147	118.9	122.8	3.078	3.079	2.959	2.956
April	3.613	3.606	2.155	2.159	124.2	124.5	3.097	3.096	2.973	2.972
May	3.632	3.621	2.167	2.167	120.3	124.5	3.113	3.108	2.993	2.984
June	3.652	3.635	2.176	2.176	117.3	120.7	3.130	3.121	3.013	3.000
July	3.664	3.649	2.184	2.184	114.7	117.5	3.138	3.132	3.023	3.015
August	3.676	3.666	2.193	2.195	106.6	115.4	3.146	3.146	3.039	3.031
September	3.689	3.682	2.202	2.206	100.3	114.4	3.154	3.159	3.053	3.045
October	3.709	3.701	2.211	2.217	102.8	115.6	3.170	3.175	3.067	3.059
November	3.728	3.718	2.221	2.227	94.2	111.7	3.185	3.187	3.091	3.075
December	3.748	3.733	2.232	2.236	97.0	110.2	3.201	3.198	3.105	3.088

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	2772.7	2766.7	381.1	385.5	932.8	932.3	1448.9	1448.8	2433.3	2427.9
August	2790.2	2788.6	402.4	402.8	937.2	934.9	1450.6	1450.9	2443.2	2440.0
September	2834.9	2844.0	437.1	455.2	936.5	931.2	1461.3	1457.6	2474.6	2476.2
October	2799.1	2789.4	384.3	391.3	944.3	934.3	1470.5	1463.8	2436.1	2423.8
November	2799.8	2806.5	379.8	386.9	941.7	939.4	1478.3	1480.3	2428.3	2432.7
December	2820.0	2863.8	382.5	434.4	949.6	946.4	1487.9	1483.0	2437.3	2479.4*
January 1987	2829.3	2821.9*	379.6	376.5*	954.5	951.8*	1495.2	1493.6*	2437.0	2433.8
February	2846.6	2842.7	384.1	382.4	958.2	956.5	1504.3	1503.8	2443.4	2442.3
March	2858.2	2854.9	386.5	385.7	957.1	958.5	1514.6	1510.7	2445.0	2446.3
April	2871.1	2869.7	389.4	389.9	958.2	959.9	1523.5	1519.9	2449.7	2452.2
May	2891.1	2881.2	393.6	390.3	964.7	963.3	1532.8	1527.6	2462.6	2454.4
June	2909.9	2897.4	393.3	395.0	976.9	967.0	1539.7	1535.4	2470.2	2461.4
July	2919.6	2911.0	395.2	396.7	975.6	971.0	1548.8	1543.3	2470.1	2463.7
August	2935.2	2926.5	396.8	398.9	980.2	974.7	1558.2	1552.9	2474.9	2467.3
September	2948.7	2940.0	399.6	401.1	980.6	978.1	1568.5	1560.8	2477.9	2470.4
October	2962.1	2954.3	397.8	403.1	986.4	981.8	1577.9	1569.4	2480.8	2474.7
November	2984.8	2969.6	405.3	404.8	993.1	985.7	1586.4	1579.1	2491.5	2479.2
December	2998.5	2981.5	404.7	404.8	998.0	989.5	1595.8	1587.2	2494.6	2479.8

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	119.80	119.80	18.88	18.88	10.7	10.7	73.49	73.49	27.43	27.43
August	121.57	121.52	19.13	19.14	12.7	12.7	73.88	73.61	28.57	28.77
September	127.19	128.33	19.22	19.30	16.1	16.1	73.83	73.71	34.13	35.32
October	121.34	121.66	19.15	19.25	10.3	10.3	74.43	73.98	27.76	28.44
November	120.18	120.94	19.53	19.25	9.5	10.5	74.22	74.23	26.43	27.46
December	121.54	126.26	19.71	19.53	9.8	13.6	74.85	74.81	26.98	31.92
January 1987	121.16	120.80*	19.61	19.46*	9.4	8.8*	75.23	75.27*	26.32	26.07*
February	122.00	121.87	19.64	19.54	9.6	9.3	75.52	75.64	26.84	26.69
March	122.21	122.43	19.62	19.62	9.9	9.6	75.44	75.80	27.15	27.01
April	122.64	123.05	19.79	19.68	10.0	10.0	75.52	75.91	27.33	27.46
May	123.67	123.37	19.99	19.81	10.2	9.9	76.04	76.18	27.64	27.38
June	124.59	124.22	20.07	19.96	10.1	10.2	77.00	76.47	27.52	27.79
July	124.71	124.75	20.06	20.03	10.2	10.2	76.89	76.79	27.76	27.93
August	125.28	125.30	20.08	20.06	10.3	10.3	77.26	77.08	27.94	28.16
September	125.45	125.84	20.13	20.12	10.3	10.4	77.29	77.35	28.03	28.37
October	125.89	126.37	20.26	20.24	10.2	10.4	77.75	77.64	27.88	28.49
November	127.31	126.89	19.99	20.18	10.6	10.5	78.27	77.95	29.05	28.76
December	127.63	127.19	20.03	20.24	10.5	10.4	78.66	78.25	28.94	28.70

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	1.782	1.782	1.137	1.137	1.759	1.759	378.1	380.7	335.2	338.9
August	1.818	1.795	1.199	1.186	1.673	1.673	382.2	382.6	338.1	340.6
September	1.680	1.664	1.116	1.102	1.613	1.603	382.8	382.6	338.2	340.4
October	1.694	1.628	1.133	1.085	1.592	1.565	384.3	379.7	338.6	338.1
November	1.687	1.585	1.143	1.087	1.576	1.613	385.5	377.0	338.8	335.3
December	1.680	1.802	1.141	1.209	1.583	1.893	385.9	380.3	338.2	338.0*
January 1987	1.713	1.598*	1.152	1.083*	1.567	1.426*	383.3	375.7*	335.1	333.7
February	1.698	1.635	1.150	1.117	1.569	1.458	380.7	375.2	332.2	332.9
March	1.685	1.640	1.136	1.126	1.543	1.492	378.7	374.7	329.6	331.9
April	1.637	1.627	1.121	1.105	1.517	1.523	379.8	371.2	329.7	328.5
May	1.625	1.606	1.115	1.103	1.483	1.501	379.7	372.0	328.7	328.6
June	1.612	1.558	1.112	1.065	1.472	1.453	379.5	371.5	327.7	327.3
July	1.615	1.540	1.120	1.026	1.470	1.427	377.8	369.5	325.7	324.7
August	1.607	1.542	1.117	1.034	1.463	1.429	376.5	367.9	324.3	322.7
September	1.600	1.553	1.099	1.056	1.438	1.435	375.7	367.8	323.0	322.1
October	1.597	1.536	1.087	1.029	1.445	1.421	376.5	368.1	322.9	321.8
November	1.593	1.538	1.084	1.016	1.452	1.426	377.9	368.0	323.3	320.8
December	1.588	1.523	1.080	1.022	1.455	1.432	379.1	368.5	323.2	320.4
	Non-Residential		Public Construction		Residential Construction					
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.				
July 1986	129.8	130.2	72.5	71.7	175.9	178.8				
August	131.9	131.4	73.6	72.4	176.7	178.8				
September	132.2	130.1	73.5	74.0	177.1	178.5				
October	132.0	129.1	74.3	71.9	178.0	178.6				
November	131.7	128.2	75.2	70.7	178.6	178.0				
December	131.2	128.5*	76.1	72.2*	178.6	179.6*				
January 1987	130.9	126.9	75.5	70.9	176.9	177.9				
February	130.6	126.4	75.1	71.3	175.0	177.5				
March	130.4	125.8	75.3	71.5	173.0	177.4				
April	130.8	125.5	75.4	72.2	173.6	173.5				
May	131.1	125.2	75.6	72.6	173.0	174.2				
June	131.2	124.8	75.6	73.0	172.7	173.7				
July	130.9	124.3	76.1	73.5	170.8	171.7				
August	130.6	124.0	76.6	73.9	169.3	170.0				
September	131.0	123.7	77.0	74.5	167.7	169.6				
October	131.1	123.5	77.2	74.9	168.2	169.7				
November	131.4	123.1	77.6	75.5	168.9	169.4				
December	131.6	122.7	78.0	76.1	169.5	169.7				

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	278.6	278.6	106.22	106.22	27.39	27.39	27.42	27.42
August	278.1	277.5	103.85	103.85	26.33	26.33	27.28	27.28
September	277.8	276.6	108.99	108.72	28.63	28.22	27.22	27.08
October	278.1	276.0	104.63	103.57	27.42	26.91	27.36	27.72
November	278.5	276.6	104.28	109.27	27.05	28.65	27.21	27.91
December	279.0	277.1*	102.89	106.94*	26.43	27.74*	27.13	28.23*
January 1987	279.8	277.5	103.17	106.57	26.46	27.21	27.19	27.74
February	280.7	278.6	104.93	107.13	26.82	27.26	27.10	27.63
March	281.6	279.5	104.86	107.29	26.95	27.45	27.15	27.81
April	282.9	280.2	106.07	107.88	27.46	27.63	27.39	27.85
May	283.5	281.0	106.89	108.32	27.89	28.05	27.67	27.94
June	284.2	281.9	106.55	107.91	27.90	27.92	27.91	28.03
July	285.7	282.5	105.93	108.39	27.51	28.03	27.84	28.12
August	286.5	283.3	105.46	108.55	27.36	28.12	27.56	28.05
September	287.6	284.2	105.67	108.12	27.45	28.05	27.79	28.09
October	289.0	285.0	106.29	107.95	27.82	28.21	27.85	28.24
November	290.1	285.7	107.43	108.16	27.99	28.29	28.01	28.33
December	291.1	286.5	108.21	108.47	28.13	28.15	28.16	28.38
	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	591.9	591.9	8.08	8.08	124.9	124.9	79.3	79.2
August	591.9	590.1	7.64	7.64	125.1	125.1	79.2	79.2
September	590.2	588.1	7.67	7.69	125.3	124.9	79.2	78.9
October	591.5	591.6	7.92	8.01	125.5	125.3	79.1	79.0
November	593.6	590.6	8.05	8.69	125.6	126.0	79.0	79.4
December	595.9	589.7*	8.18	8.43	125.7	126.6	78.9	79.6
January 1987	597.8	591.3	8.21	8.50*	125.9	126.9*	78.9	79.6*
February	599.4	594.0	8.15	8.52	126.0	127.2	78.8	79.7
March	602.3	596.2	8.26	8.56	126.2	127.3	78.8	79.5
April	604.6	597.9	8.30	8.60	126.8	127.4	79.2	79.4
May	606.9	600.1	8.34	8.57	127.4	127.6	79.6	79.4
June	608.7	601.8	8.38	8.64	128.0	127.8	80.0	79.4
July	611.5	603.5	8.46	8.70	128.0	127.9	79.8	79.3
August	613.4	605.2	8.57	8.57	128.0	128.1	79.6	79.3
September	615.7	607.1	8.69	8.65	127.9	128.4	79.3	79.4
October	618.0	609.0	8.42	8.93	127.7	128.6	78.9	79.4
November	619.9	611.4	8.65	9.07	127.7	128.8	78.7	79.4
December	622.6	613.7	9.03	8.90	127.9	128.9	78.7	79.3

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	327.6	327.6	287.3	287.0	308.5	308.5	114.7	114.7
August	328.2	328.2	288.3	288.2	307.7	307.7	114.9	115.0
September	329.2	329.3	289.5	289.3	308.8	308.8	115.3	115.3
October	330.3	329.8	290.4	290.3	310.0	309.3	115.6	115.0
November	331.1	330.7	291.0	290.9	310.5	309.6	115.9	115.3
December	332.0	331.5	292.0	290.9	311.1	309.3	116.3	115.6
January 1987	333.2	333.2*	293.1	291.8*	311.7	312.7*	116.7	116.0*
February	334.4	334.6	294.2	294.0	312.2	314.2	117.1	116.4
March	335.5	335.5	295.0	295.1	312.4	314.9	117.3	116.7
April	336.5	336.2	295.8	295.6	313.0	315.2	117.6	117.0
May	337.4	337.0	296.6	296.2	313.3	315.5	118.0	117.4
June	338.3	337.9	297.4	296.8	313.6	316.3	118.3	117.7
July	339.3	339.2	298.1	297.5	313.9	316.6	118.6	118.1
August	340.2	340.5	298.9	298.2	313.3	317.1	119.0	118.5
September	341.1	341.7	299.6	298.9	311.2	315.3	119.4	118.9
October	342.2	342.8	300.6	300.0	314.3	318.2	119.8	119.3
November	343.3	343.8	301.6	301.0	315.1	319.0	120.1	119.7
December	344.4	344.9	302.5	302.1	315.9	319.7	120.4	120.1

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	113.9	114.0	105.5	105.3	106.1	106.1	122.4	122.5	112.8	112.4
August	114.2	114.3	105.8	105.7	106.4	106.4	122.8	122.9	113.0	112.3
September	114.5	114.9	106.3	106.5	106.7	107.1	123.2	123.6	113.1	112.4
October	114.9	115.1	106.5	105.4	106.9	107.1	123.7	124.0	113.5	112.3
November	115.3	115.4	106.3	105.7	107.1	107.3	124.1	124.3	113.8	112.4
December	115.7	115.5*	106.2	106.5*	107.5	107.5*	124.5	124.5*	114.1	112.5*
January 1987	116.1	115.9	106.5	105.8	107.9	107.9	125.0	124.9	114.4	112.6
February	116.5	116.4	106.7	106.0	108.1	108.4	125.5	125.4	114.6	112.7
March	116.9	116.7	106.9	106.3	108.2	108.6	126.0	125.8	114.9	112.9
April	117.2	117.0	107.1	106.6	108.5	108.7	126.4	126.3	115.2	113.0
May	117.4	117.4	107.3	106.9	108.8	108.9	127.0	126.8	115.5	113.2
June	117.8	117.7	107.5	107.1	109.1	109.2	127.5	127.2	115.8	113.5
July	118.2	118.2	107.6	107.4	109.3	109.5	128.1	127.8	116.0	113.8
August	118.6	118.6	107.8	107.8	109.5	109.9	128.6	128.3	116.1	114.0
September	119.0	119.0	108.0	108.1	109.8	110.2	128.9	128.8	116.3	114.2
October	119.4	119.4	108.2	108.5	110.2	110.5	129.4	129.2	116.6	114.4
November	119.8	119.8	108.4	108.8	110.6	110.8	130.0	129.7	116.9	114.7
December	120.2	120.2	108.6	109.1	111.0	111.1	130.6	130.3	117.3	115.0

Fore. = November Forecast

C.E. = Current Expectations

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	-16.06	-16.06	179.4	179.4	4210	4220	3670	3678	9.4	9.4
August	-13.32	-14.04	179.1	179.1	4233	4241	3684	3688	13.6	9.5
September	-16.67	-14.74	179.3	179.5	4260	4261	3695	3694	-4.1	-3.9
October	-15.62	-14.71	179.8	180.4	4276	4250	3699	3696	-6.7	-6.3
November	-15.29	-19.22	179.9	182.5	4289	4268	3701	3702	-11.3	-9.4
December	-14.84	-15.28p	179.6	184.1*	4305	4287	3702	3708	-13.5	-11.3
January 1987	-15.29	-14.36*	179.3	183.5	4323	4299	3704	3706	-11.6	-14.2
February	-15.07	-13.79	179.4	183.2	4347	4330	3712	3720	-10.8	-12.6
March	-14.85	-14.05	179.7	183.6	4370	4349	3725	3727	-9.9	-10.5
April	-14.63	-13.83	180.0	183.4	4398	4360	3740	3726	-8.9	-6.3
May	-14.41	-13.65	180.2	182.7	4426	4382	3751	3733	-7.3	-4.1
June	-14.18	-13.61	179.8	181.9	4454	4396	3765	3735	-6.7	-6.2
July	-15.66	-13.46	179.5	182.4	4467	4422	3766	3744	-1.2	-8.1
August	-15.27	-13.35	179.7	182.1	4480	4437	3765	3744	-1.3	-10.2
September	-14.68	-13.88	180.2	182.6	4492	4449	3762	3742	-5.0	-11.3
October	-14.72	-13.92	180.6	181.8	4517	4470	3770	3747	-9.9	-11.8
November	-14.64	-13.71	180.9	181.5	4536	4497	3777	3757	-15.6	-12.9
December	-14.56	-13.63	181.3	182.4	4556	4520	3784	3764	-19.9	-14.4

Fore. = November Forecast

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	245.5	245.7	676.1	676.0	2699.1	2699.2	6.56	6.56	5.86	5.86
August	246.8	247.7	687.8	687.6	2723.8	2724.3	6.17	6.17	5.55	5.55
September	248.6	248.7	693.3	693.2	2740.6	2740.8	5.89	5.89	5.35	5.35
October	250.5	250.8	701.8	701.2	2758.4	2765.2	5.83	5.85	5.30	5.26
November	252.9	252.9	707.3	713.5	2773.5	2781.4	5.76	6.04	5.20	5.41
December	255.3	254.5	712.8	730.4	2788.2	2804.3	5.68	6.91	5.16	5.55
January 1987	256.4	257.3*	719.2	735.9*	2804.6	2823.9*	5.37	6.15*	4.91	5.43*
February	257.3	259.0	723.0	739.9	2822.5	2839.8	5.20	6.00	4.95	5.36
March	258.3	260.4	727.8	743.6	2840.8	2855.8	5.16	5.76	4.99	5.17
April	260.1	261.3	732.9	748.5	2859.3	2871.7	5.22	5.43	5.02	5.01
May	262.0	262.4	736.5	754.0	2876.9	2889.9	5.27	5.37	5.03	4.93
June	263.9	264.0	740.1	758.2	2894.5	2909.2	5.33	5.42	5.05	5.12
July	265.2	265.7	744.3	765.4	2910.6	2931.5	5.50	5.48	5.30	5.20
August	266.7	267.2	747.6	771.2	2923.9	2950.9	5.56	5.57	5.34	5.26
September	268.3	268.6	750.9	775.7	2937.2	2967.6	5.62	5.88	5.38	5.38
October	269.9	270.3	756.0	782.9	2956.1	2988.9	5.65	6.03	5.30	5.47
November	271.2	271.8	762.1	788.2	2974.5	3011.9	5.69	5.96	5.26	5.54
December	273.5	273.2	768.1	794.6	2992.8	3033.7	5.73	6.13	5.22	5.45

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1986	8.88	8.88	7.51	7.51	6.33	6.33	6.37	6.37	8.16	8.16
August	8.72	8.72	7.21	7.21	5.92	5.92	5.92	5.92	7.90	7.90
September	8.89	8.89	7.11	7.11	5.68	5.68	5.71	5.71	7.50	7.50
October	8.93	8.86	7.06	7.08	5.73	5.68	5.75	5.69	7.50	7.50
November	8.76	8.68	6.89	6.85	5.70	5.76	5.72	5.76	7.50	7.50
December	8.53	8.49	6.65	6.86	5.64	6.10	5.67	6.04	7.50	7.50
January 1987	8.56	8.38*	6.68	6.53*	5.30	5.85*	5.26	5.87*	7.39	7.50*
February	8.50	8.59	6.61	6.74	5.17	5.90	5.15	5.95	7.00	7.50
March	8.60	8.43	6.71	6.58	5.12	5.75	5.12	5.84	7.00	7.50
April	8.65	8.22	6.76	6.33	5.17	5.42	5.20	5.45	7.00	7.38
May	8.57	8.10	6.69	6.20	5.26	5.28	5.33	5.29	7.00	7.25
June	8.62	8.17	6.75	6.23	5.35	5.35	5.41	5.37	7.00	7.25
July	8.97	8.35	7.23	6.39	5.63	5.46	5.69	5.52	7.08	7.25
August	9.20	8.58	7.44	6.56	5.68	5.63	5.80	5.74	7.50	7.39
September	9.22	8.72	7.47	6.71	5.70	5.89	5.84	5.98	7.50	7.50
October	8.99	8.91	7.24	6.91	5.73	6.05	5.86	6.17	7.50	7.62
November	8.90	8.86	7.14	6.91	5.75	6.03	5.89	6.20	7.50	7.75
December	8.87	8.89	7.10	6.95	5.72	6.17	5.85	6.29	7.50	7.75

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3/23/87 W 1880 -3

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MONTHLY PROJECTIONS February 1987

Dr. Donald Ratajczak, Director
For Release: March 10, 1987

WHAT IS HAPPENING TO AMERICAN PRODUCTIVITY?

During the fourth quarter, productivity in the private nonfarm economy fell at an annual rate of 2.2%. Such a decline is not surprising when economic growth slows abruptly, as it did to a 1.3% GNP gain during the fall. Normally, employers like to maintain stable hiring schedules. If activity falls hours initially are reduced. If activity is expected to remain light, then reductions in hiring programs are initiated. Thus, the fourth quarter poor productivity performance normally would be followed by a reduction in hours during the first quarter unless a substantial spurt in economic activity began to materialize.

Economic activity is strengthening early in 1987, but the gains appear to be in inventory accumulation and a modest improvement in the trade accounts. While some inventory rebuilding is necessary, as manufacturers were liquidating inventories almost through the previous year, a 0.5% monthly gain in manufacturing inventories in January soon should lead to relatively full warehouses if it persists. Moreover, the slump in manufacturing orders in January suggests that much of the orders spurt during the fourth quarter was induced by attempts to get equipment delivered before the new tax year began. In other words, producers probably over-estimated the sustainability of orders growth that developed during the fall.

Nevertheless, both the work week and employment have grown at a faster rate during the first quarter. The preliminary index of hours worked for February is 7.4% above fourth quarter averages at annual rates. Even with a significant inventory rebound during the first quarter, economic activity probably is only growing in the vicinity of 3 - 3.5%. Thus, productivity continues to deteriorate. To be sure, the manufacturing sector is not joining in this poor productivity performance. While hours worked are increasing in that sector, industrial activity appears to be growing at least in pace. Rather, most of the poor productivity performance appears to be in the distribution and service industries. Some of the productivity weakness in the service economy may be the result of measurement errors. As many service activities are "made to order", it is difficult to evaluate the effectiveness of performing activities. Thus, many service activities are evaluated in terms of their inputs rather than on the basis of some independently measured outputs.

However, productivity weakness in the distribution industries is more disturbing. Apparently, customer convenience has been met at the expense of the amount of customers being served per employee. This could be the end of a growth cycle, especially in retail establishments, where stores have grown more rapidly than customers. Part of this growth may have been stimulated by developers, who built units ahead of population needs and then enticed department chains into the shopping areas with rent concessions and the fear that their competitors may get there first. To the extent that developer overbuilding is responsible for rapid hiring activity in retail establishments, these employment gains should slow as financing of such construction efforts begins to diminish.

Nevertheless, the surprisingly poor productivity gains raise serious questions about inflationary pressures in 1987. Most analysts assume that wage costs per hour worked will not grow any more rapidly in 1987 than 1986. Early wage surveys suggest that such an assumption is valid. Then, assuming that modest productivity gains will materialize, unit labor costs are projected to increase less than 2.5% in 1987. Allowing for increases in raw material costs, especially as energy prices are drifting upward, and also allowing for some inflationary pressures from higher import prices, inflation projections between 3% and 3.5% appear to be valid. However, the hours worked during the first quarter suggest that there will be no productivity gains in 1987 and there may actually be a slight decline in productivity. If so, unit labor costs could be increasing as much as 3.5% to 4.0%. Again, adding some price increases for imported goods and rising oil prices, inflation rates in excess of 4% could easily materialize.

In the meantime, Saudi Arabia has once again accepted the role as the swing producer. Because of that country's refusal to sell oil at less than \$18 per barrel, the amount of oil shipped from Saudi Arabia will decline sufficiently to remove any oil excesses that otherwise will prevail at \$18 per barrel. Therefore, oil prices now are expected to be higher in 1987 than in 1986, when prices averaged \$16.07 for imported oil. This price increase means that oil will be 5% more expensive than originally anticipated. Assuming fuel oil prices rise by half that amount (for coal and natural gas prices should not reflect fully the new, higher oil prices), our estimates of inflation must be marked up by 0.4% for 1987. Of course, if Saudi Arabia continues to be the swing producer in maintaining \$18 per barrel in 1988, oil inflation in that year will be slightly less than contained in our forecast.

The poor productivity gains outside of manufacturing that appear to be developing suggest that corporate profitability may not improve as much in 1987 as originally projected. Furthermore, higher projected inflation rates than originally anticipated suggest that interest rates may be higher toward the end of the year than originally expected. The combined effects of reduced earnings gains and rising interest rates suggests that stock market values should be vulnerable to a significant downside movement during the second half of this year. Indeed, stock market values appear to be in excess of what can be justified by normal valuation formulas. However, a significant correction may not develop until interest rates begin rising, which is not anticipated until the late summer months.

Quarterly Profile of GNP

	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1987 Annual</u>
Real:	1.3	3.6	2.7	1.5	2.5	2.2	2.4
Price:	0.7	3.5	3.8	4.2	4.4	4.4	3.1
Nominal:	1.9	7.3	6.6	5.8	6.9	6.7	5.5

Monthly Statistical Highlights for February 1987

Personal income +0.4%; savings rate 3.0%; personal consumption +1.2%; retail sales +2.1%; auto sales 9.7 million units; housing starts -4.2%; housing permits -2.0%; construction expenditures -0.3%; business inventories +0.6%; orders for durable goods +4.5%; orders for nondefense capital goods +3.7%; industrial production +0.6%; CPI +0.5%; PPI +0.5%; consumption deflator +0.3%; leading indicators +0.6%; real GNP 5.6%; M1 -1.0%; M2 +1.8%.

Monthly Statistical Highlights for March 1987

Payroll employment +211,000; index of hours worked +0.2%; household employment +247,000; civilian unemployment rate 6.6%; personal income +0.5%; savings rate 2.9%; personal consumption +0.5%; retail sales +0.4%; auto sales 9.7 million units; housing starts -1.2%; housing permits -1.9%; construction expenditures +0.3%; business inventories +0.5%; orders for durable goods +0.8%; orders for nondefense capital goods +3.8%; industrial production +0.2%; CPI +0.3%; PPI +0.5%; consumption deflator +0.2%; leading indicators -0.4%; real GNP +5.3%; M1 +6.4%; M2 +6.4%.

COMMENTARY

Employment - Almost all the employment indicators in February were surprisingly robust. Payroll employment increased 337,000 while goods production increased 50,000. However, more than 30,000 of the gain in goods production was the result of strikers returning to work in the steel and machinery industries. The manufacturing work week expanded by 0.3 hours to reach its highest level of the cycle. Hours also expanded for the total economy. The index of hours worked in the private economy rose a surprisingly robust 1.1%. Furthermore, the hourly earnings index rose a strong 0.5%. Obviously, such gains imply strong growth in wage earnings during the month. As mentioned above, the increase in hours worked is a surprise because orders are again falling off. Most economic activity appears to be producing for inventory. One possibility for this surprising increase in the work week may be an attempt to catch up for production that had been lost during severe winter storms between the two employment survey weeks. If that proves to be the case, the hours worked will be overstating the true amount of hours used throughout the month.

The diffusion index was reasonably strong at more than 59%. However, the previously announced 61% gain in the diffusion index for January was revised downward to show a relatively sluggish 53% gain.

Personal Income and Outlays - Wage income should increase sharply in February as a result of the expansion in hours and earnings. In addition, farm income should rebound from an unusually low level in January. On the other hand, interest payments are continuing to decline while transfer payments should slow following inflation adjustments in January. Because of problems with the W-4, many workers have not adjusted their estimated allowances to conform with the reduced deductibility permitted under the new tax codes. However, withholding tables per allowance have been reduced because of the decline in the marginal tax rates and the increased deductions and exemptions. As a result, many workers will be under-withheld during the first half of this year. This will significantly slow tax collections and possibly add as much as a percentage point to disposable income during this time.

The return of automobile incentives has once again excited automobile sales. Nevertheless, the unusually low savings rate should prevent any surge in automobile sales during 1987. Low savings should persist through most of the year because of the consumption effects associated with substantial stock market gains. Service outlays should grow more slowly in February following a sharp rebound for financial services in January. Price effects will be much more dominant in the increase in purchases of nondurables as both food and gasoline prices are rising early in 1987.

Construction - Housing permits remain surprisingly robust in January despite the sharp decline in permits in the west. Apparently, the big increase in permits occurred in the midwest and may be related to unusually mild weather. The weather was more normal in February and should generate slower housing activity.

Other construction outlays may also have been influenced by the weather. Although nonresidential construction is continuing to fall sharply, there was a rebound in public construction. In addition, the rebound in housing starts was reflected in residential construction expenditures. Those expenditures should continue to rise for the next few months, barring weather problems. However, the continuing sharp falloff in nonresidential activity should lead to significantly lower construction expenditures in the second half of 1987 than had previously been anticipated.

Business Activity - Manufacturing inventories increased sharply in January and are projected to continue growing, but at slower rates in subsequent months. This increase in inventories appears to be desired as a result of unanticipated increases in orders during the fall. However, orders have since fallen sharply. Part of the weakness in orders during January reflects a surprisingly large \$4.5 billion reduction in machinery orders. This may be related to the shift in depreciation accounting that occurred in January. If so, a gradual increase in orders will then materialize in the months ahead. The drop in defense shipments is more difficult to explain. Possibly, this was partially the result of bad weather. It is also possible that some of the weakness in January orders was the result of many airports in the east being closed for several days during the month. If so, a rebound should be anticipated in February and beyond.

Prices - Only half the PPI energy price increase was registered in the CPI during January. As a result, another sharp increase in CPI prices is anticipated in February. The PPI, however, has more favorable seasonal factors in February. Also, the surge in food prices is beginning to abate. Energy prices probably will diminish in March before re-accelerating again in April. This appears to be the result of the latest initiative by Saudi Arabia to reduce production in order to sustain \$18 per barrel oil.

The surge in automobile sales in December created a huge surge in the durable goods deflator as a result of the shift in composition. The composition will shift back in January causing a significant moderation in the durable goods deflator. On the other hand, surprisingly sluggish price gains for consumer services should be nearing an end. The CPI showed a sharp increase in housing prices in January following virtually no gains in December. Thus, service inflation should intensify next quarter.

Miscellaneous - The weakness in the leading indicators in January can be ignored because of unusually sharp gains in the indicators during December. Continued gains in stock market prices and a strong gain in the manufacturing work week will add to the indicators in February.

Financial Markets

The Federal Reserve apparently is attempting to restrain money growth in February. This not only is partially responsible for the absence of any substantial growth in the monetary aggregates but also explains the significant slowing in the growth of the monetary base. However, the Federal Reserve appears to have created enough restraint to cause short-term interest rates to rise modestly. We currently believe that the Federal Reserve is willing to tolerate a 6.25% federal funds target for the month of March.

Fortunately, Federal Reserve restraint is occurring at a time when inventory rebuilding is gradually diminishing following a spurt in January. As a result, money growth can slow without any significant increase in short-term interest rates. Previously, we had anticipated that oil prices would be falling during the spring. This would permit the Federal Reserve to ease credit market conditions slightly. However, Saudi Arabia's willingness to serve as swing producer once again in OPEC suggests that inflationary moderation will not develop. Even with a slowing in inventory rebuilding, enough money demand probably will persist to prevent any significant decline in short-term interest rates during the spring. Indeed, it now appears that very little change will develop in interest rates through the summer months. At the end of summer, interest rates are expected to show modest upward pressure.

Equity Markets - The equity markets continue to be fooled by the increase in reported profitability as a result of gradually rising commodity inflation. Corporate profits still appear to be increasing by nearly 20% as measured by after-tax profits. However, operating profits less tax liabilities should only be up 7% to 8%. This means that a significant distortion is occurring in corporate profitability. Apparently, equity owners continue to ignore the reduced quality of their profits. Moreover, stock markets tend to overshoot estimates of stock market values based upon traditional valuation formulas. The stock market currently is in the process of overshooting and may actually continue to do so, at least until after the latest spate of IRA money is invested after the middle of April. A stock market correction now is anticipated before the end of spring, although a significant decline back to the level of 2000 is not anticipated until the end of the year.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	100826	100826	118.6	118.6	110192	110192	6.9	6.9	170.0	170.0
November	101065	101068	119.3	119.3	110432	110432	6.9	6.9	170.9	170.8
December	101334	101293	119.0	119.0	110637	110637	6.7	6.7	170.8	170.6
January 1987	101542	101741	119.5	119.8	110857	111011	6.7	6.7	171.2	170.8
February	101770	101842	119.8	119.9*	111092	111152*	6.7	6.7*	171.6	171.1*
March	102010	102053	120.2	120.1	111582	111399	6.6	6.6	172.0	171.5
April	102197	102226	120.4	120.3	111723	111617	6.6	6.6	172.3	171.8
May	102378	102416	120.6	120.5	111892	111822	6.6	6.6	172.6	172.2
June	102583	102603	120.8	120.7	111794	112050	6.6	6.6	172.8	172.5
July	102769	102851	121.0	121.0	112093	112403	6.6	6.5	173.2	172.9
August	102979	102994	121.3	121.1	112406	112504	6.7	6.5	173.7	173.4
September	103188	103179	121.5	121.4	112725	112715	6.6	6.5	174.1	173.8
October	103356	103364	121.7	121.6	112846	113007	6.5	6.4	174.5	174.2
November	103532	103546	121.9	121.8	113009	113167	6.5	6.4	174.8	174.6
December	103690	103729	122.1	122.0	113205	113374	6.4	6.4	175.1	175.0
January 1988	103857	103902	122.3	122.2	113398	113529	6.4	6.4	175.9	175.5
February	104060	104086	122.5	122.4	113587	113773	6.4	6.3	176.7	176.1
March	104188	104223	122.6	122.6	113773	113933	6.4	6.3	177.4	176.7

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	3.519	3.518	2.102	2.102	102.8	193.0	2.991	2.990	2.888	2.896
November	3.527	3.524	2.112	2.112	88.2	88.1	2.994	2.991	2.905	2.902
December	3.555	3.547	2.119	2.115	55.7	39.3	3.019	3.004	2.963	2.965
January 1987	3.560	3.548	2.133	2.127	139.3	118.4	3.059	3.027	2.920	2.908
February	3.574	3.562*	2.145	2.135*	119.4	92.6*	3.067	3.039*	2.948	2.946*
March	3.588	3.581	2.157	2.145	106.7	89.0	3.075	3.056	2.968	2.967
April	3.602	3.596	2.165	2.154	108.5	85.8	3.092	3.068	2.984	2.982
May	3.617	3.611	2.173	2.164	108.3	84.6	3.104	3.079	2.996	2.994
June	3.633	3.626	2.180	2.173	111.3	86.5	3.117	3.091	3.006	3.005
July	3.647	3.644	2.191	2.184	103.9	85.2	3.125	3.105	3.021	3.020
August	3.661	3.662	2.203	2.194	91.6	79.0	3.133	3.119	3.041	3.040
September	3.675	3.671	2.215	2.206	79.7	64.2	3.141	3.124	3.061	3.060
October	3.695	3.689	2.222	2.217	84.4	67.0	3.156	3.137	3.072	3.070
November	3.704	3.706	2.231	2.227	75.1	70.6	3.161	3.149	3.086	3.078
December	3.734	3.727	2.240	2.238	87.7	68.2	3.186	3.165	3.098	3.097
January 1988	3.739	3.734	2.254	2.249	104.0	100.0	3.219	3.206	3.115	3.106
February	3.760	3.754	2.262	2.262	106.6	96.3	3.236	3.224	3.129	3.128
March	3.783	3.773	2.270	2.274	110.4	98.0	3.255	3.241	3.145	3.143

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	2789.4	2797.9	391.3	398.2	934.3	934.4	1463.8	1465.3	2423.8	2430.6
November	2806.5	2803.6	386.9	382.3	939.4	938.1	1480.3	1483.3	2432.7	2431.3
December	2863.8	2866.1	434.4	432.5	946.4	946.7	1483.0	1486.9	2478.8	2480.2
January 1987	2820.0	2809.4	375.6	363.0	950.3	948.0	1494.1	1498.3	2428.9	2420.4*
February	2846.8	2843.4*	386.5	379.0*	955.8	954.7*	1504.5	1509.7*	2439.4	2441.5
March	2866.7	2858.2	390.5	379.9	961.2	959.5	1515.0	1518.8	2443.9	2449.0
April	2881.2	2869.3	392.7	378.2	964.8	962.0	1523.7	1529.1	2452.1	2449.6
May	2892.8	2883.9	394.9	381.8	965.9	965.5	1532.0	1536.6	2455.7	2454.1
June	2902.2	2894.9	395.6	382.3	966.3	967.9	1540.3	1544.7	2457.4	2454.1
July	2916.8	2911.4	395.1	384.7	970.6	971.6	1551.1	1555.1	2463.5	2459.2
August	2936.3	2925.7	400.3	386.5	974.7	975.3	1561.3	1563.9	2471.6	2462.4
September	2955.4	2937.0	404.6	384.6	978.8	979.6	1572.0	1572.8	2479.4	2461.5
October	2964.9	2955.4	401.5	390.0	983.0	982.9	1580.4	1582.5	2479.0	2467.9
November	2978.6	2972.6	403.8	392.4	986.7	988.6	1588.1	1591.6	2480.1	2474.2
December	2990.3	2985.5	404.0	391.6	990.5	993.5	1595.8	1600.4	2477.5	2475.7
January 1988	3006.2	2998.8	405.6	394.2	994.3	995.8	1606.3	1608.8	2482.4	2477.7
February	3019.8	3011.9	404.9	395.5	997.1	998.5	1617.8	1617.9	2485.4	2478.1
March	3034.4	3028.8	405.1	397.8	1000.0	1002.5	1629.3	1628.5	2487.2	2483.4

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	121.66	121.66	19.25	19.25	10.3	10.3	73.98	73.98	28.44	28.44
November	120.94	121.06	19.25	19.27	10.5	10.5	74.23	74.04	27.46	27.75
December	126.26	126.59	19.53	19.62	13.6	13.6	74.81	74.75	31.92	32.22
January 1987	120.53	119.27	19.46	19.55	8.8	8.3	75.23	74.73	25.84	25.00
February	121.13	121.77*	19.32	19.50*	9.3	9.7*	75.56	75.26*	26.25	27.01*
March	122.60	122.27	19.30	19.46	9.7	9.7	75.92	75.64	27.38	27.17
April	122.86	122.25	19.35	19.49	9.9	9.6	76.21	75.83	27.30	26.93
May	123.39	122.97	19.40	19.45	10.1	9.9	76.35	76.11	27.64	27.41
June	123.88	123.22	19.47	19.55	10.2	9.8	76.49	76.30	27.92	27.37
July	124.33	124.25	19.50	19.52	10.1	10.1	76.73	76.59	28.10	27.69
August	125.02	124.31	19.56	19.58	10.2	10.2	77.08	76.88	28.38	27.85
September	125.32	124.42	19.53	19.67	10.2	10.0	77.42	77.22	28.37	27.53
October	125.98	125.34	19.58	19.70	10.2	10.1	77.72	77.48	28.68	28.16
November	126.54	126.09	19.55	19.64	10.3	10.3	78.03	77.93	28.96	28.52
December	126.80	126.38	19.50	19.60	10.3	10.2	78.35	78.32	28.95	28.46
January 1988	127.09	126.88	19.57	19.66	10.3	10.3	78.52	78.50	29.00	28.72
February	127.22	127.25	19.64	19.73	10.2	10.3	78.86	78.71	28.72	82.81
March	127.75	127.85	19.71	19.75	10.2	10.4	79.20	79.03	28.84	29.07

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	1.628	1.657	1.085	1.114	1.565	1.565	379.7	384.3	338.1	342.3
November	1.585	1.637	1.087	1.129	1.613	1.613	377.0	378.4	335.3	336.7
December	1.802	1.808	1.209	1.225	1.893	1.910	380.3	374.9	338.0	333.1
January 1987	1.613	1.806	1.088	1.255	1.496	1.689	380.7	378.5	337.8	336.7
February	1.597	1.731*	1.075	1.136*	1.523	1.656*	375.4	377.3*	332.2	335.1*
March	1.610	1.711	1.091	1.149	1.516	1.624	374.7	378.4	331.0	335.5
April	1.633	1.684	1.103	1.131	1.534	1.597	375.6	374.9	331.2	331.8
May	1.641	1.638	1.110	1.116	1.556	1.546	376.4	372.6	331.6	329.4
June	1.641	1.599	1.111	1.093	1.550	1.513	377.7	371.0	332.8	327.4
July	1.631	1.592	1.122	1.086	1.542	1.487	376.8	368.8	331.4	324.9
August	1.620	1.610	1.115	1.099	1.533	1.513	377.3	367.1	331.0	322.9
September	1.621	1.600	1.120	1.078	1.519	1.505	376.8	367.6	329.7	322.5
October	1.626	1.589	1.126	1.086	1.533	1.496	376.0	367.1	328.7	321.5
November	1.609	1.595	1.113	1.094	1.516	1.503	375.9	366.9	327.7	320.4
December	1.621	1.599	1.129	1.106	1.518	1.506	376.5	366.9	327.7	319.6
January 1988	1.621	1.618	1.116	1.082	1.524	1.531	376.8	367.1	327.4	318.9
February	1.636	1.591	1.125	1.075	1.518	1.511	376.7	368.1	326.7	319.3
March	1.623	1.575	1.120	1.073	1.522	1.493	378.4	369.0	327.3	319.2

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	129.1	128.8	71.9	73.6	178.6	181.9
November	128.2	126.5	70.7	69.8	178.0	182.1
December	128.5	125.2	72.2	71.2	179.6	178.6
January 1987	128.6	122.5	72.5	75.2	179.6	180.7
February	127.8	121.3*	71.8	73.6*	175.8	182.4*
March	127.0	120.5	71.0	73.1	176.7	184.8
April	126.8	118.9	72.3	73.4	176.5	182.6
May	126.5	118.3	73.7	74.6	176.2	179.7
June	126.4	118.0	75.1	75.1	176.2	177.9
July	126.6	117.4	74.6	75.5	175.6	175.9
August	126.8	117.1	75.1	75.4	175.4	174.6
September	126.8	117.0	74.9	76.0	175.1	174.6
October	127.5	116.6	73.9	75.6	174.6	174.9
November	128.2	116.3	73.6	75.9	174.1	174.7
December	129.0	116.0	73.8	76.3	173.7	174.6
January 1988	128.0	116.1	74.3	76.5	174.5	174.5
February	126.5	116.0	74.9	76.8	175.3	175.3
March	126.8	116.2	75.6	77.2	176.0	175.6

Fore. = February Forecast

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BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	276.0	276.0	103.57	103.57	26.91	26.91	27.72	27.72
November	276.6	276.4	109.27	108.83	28.65	28.44	27.91	27.63
December	275.3	275.5	106.94	110.41	27.74	30.05	28.23	29.21
January 1987	277.8	277.0	103.46	102.97	26.43	24.94	27.06	25.00
February	279.5	278.7*	105.92	107.62*	27.17	25.86*	27.11	26.13*
March	279.3	279.7	106.42	108.46	27.61	26.83	27.56	26.68
April	280.9	281.1	107.72	107.45	28.13	27.24	27.94	27.13
May	282.0	282.2	107.93	108.63	28.52	27.62	28.06	27.46
June	283.0	283.4	106.85	108.13	28.35	27.28	28.04	27.43
July	284.2	284.5	106.14	108.86	28.05	27.29	28.17	27.54
August	285.5	285.7	106.26	109.26	28.19	27.46	28.26	27.59
September	286.5	286.7	106.52	108.67	28.32	27.62	28.35	27.68
October	288.1	288.0	107.83	106.67	28.86	27.83	28.57	27.85
November	289.8	289.3	108.84	107.08	29.03	27.56	28.75	27.92
December	291.1	290.7	110.23	107.63	29.62	27.79	28.93	27.95
January 1988	292.7	292.0	106.92	108.54	27.46	28.26	28.56	28.13
February	294.0	293.6	108.25	108.86	28.05	28.15	28.82	28.29
March	295.0	295.1	108.59	109.28	28.46	28.35	29.00	28.43

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	591.6	591.6	8.01	8.01	125.3	125.3	79.0	79.0
November	590.6	589.9	8.69	8.69	126.0	126.0	79.4	79.4
December	590.5	587.2	8.43	9.18	126.6	126.4	79.6	79.5
January 1987	593.7	593.5*	8.46	7.42	126.9	126.9	79.7	79.7
February	597.5	597.3	8.59	7.86*	127.1	127.7*	79.9	80.1*
March	597.9	600.2	8.73	8.09	127.4	128.0	79.9	80.1
April	599.4	603.6	8.56	8.39	127.6	128.3	79.9	80.1
May	602.2	605.3	8.82	8.53	127.8	128.6	79.9	80.2
June	604.8	607.6	8.87	8.66	128.1	128.8	80.0	80.1
July	607.3	609.5	8.83	8.73	128.1	129.1	79.8	80.1
August	609.5	611.8	8.76	8.70	128.2	129.2	79.7	80.0
September	611.4	614.1	9.36	9.13	128.7	129.5	79.9	80.0
October	614.2	616.5	8.92	8.67	129.2	129.8	80.2	80.1
November	618.3	618.9	8.95	8.73	129.6	130.0	80.3	80.1
December	621.0	621.7	9.00	8.89	129.8	130.2	80.3	80.0
January 1988	624.6	624.8	9.12	8.85	130.0	130.5	80.3	80.0
February	626.9	627.9	9.16	8.93	130.0	130.7	80.1	80.0
March	628.6	630.6	9.21	8.99	130.1	130.8	80.1	79.9

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	329.8	329.8	290.3	290.3	309.3	309.3	115.0	115.0
November	330.7	330.7	290.9	290.9	309.6	309.6	115.3	115.2
December	331.5	331.5	290.9	290.9	309.3	309.3	115.6	115.4
January 1987	333.0	334.0	291.8	291.7	312.3	313.6	116.1	115.9
February	334.7	335.7*	294.0	293.2*	314.7	315.8*	116.6	116.3*
March	335.5	336.6	295.1	294.6	316.5	316.0	117.1	116.5
April	336.2	337.8	295.6	296.2	314.7	316.4	117.4	116.9
May	337.0	339.1	296.2	297.1	312.8	317.2	117.6	117.3
June	338.7	340.4	296.8	298.1	312.4	317.6	117.6	117.7
July	339.5	341.3	297.5	298.8	313.0	318.1	118.0	118.1
August	340.1	342.3	298.2	299.4	314.3	318.5	118.5	118.5
September	340.7	343.6	298.9	300.2	312.9	316.3	118.9	119.0
October	341.9	344.8	300.0	301.1	315.7	319.8	119.1	119.4
November	343.4	345.7	301.0	301.5	316.1	320.4	119.3	119.8
December	345.0	346.9	302.1	302.3	316.5	321.1	119.6	120.2
January 1988	346.0	348.1	303.1	303.1	318.3	322.5	120.1	120.7
February	347.0	349.3	304.2	304.1	320.2	324.0	120.7	121.1
March	348.1	350.5	305.4	305.3	322.0	325.4	121.3	121.5

	Consumption		Consumer		Consumer		Consumer		implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	115.1	115.1	105.4	105.6	107.1	107.1	124.0	124.0	112.3	112.3
November	115.4	115.3	105.7	105.4	107.3	107.3	124.3	124.2	112.4	112.4
December	115.5	115.6	106.5	106.9	107.5	107.8	124.5	124.2	112.5	112.5
January 1987	116.1	116.1*	106.0	106.0*	108.3	108.4*	125.0	124.5*	112.7	112.4
February	116.7	116.5	106.2	106.2	109.1	109.0	125.5	124.9	113.0	112.6*
March	117.3	116.7	106.5	106.4	109.6	109.3	126.1	125.2	113.2	112.8
April	117.5	117.1	106.7	106.7	109.8	109.6	126.6	125.6	113.4	113.0
May	117.8	117.5	106.9	107.0	109.8	110.0	126.9	126.0	113.5	113.1
June	118.1	118.0	107.2	107.3	109.9	110.4	127.3	126.5	113.5	113.3
July	118.4	118.4	107.4	107.5	110.1	110.8	127.9	127.0	113.7	113.5
August	118.8	118.8	107.6	107.8	110.4	111.3	128.4	127.4	114.0	113.7
September	119.2	119.3	107.8	108.1	110.7	111.7	128.8	128.0	114.3	114.0
October	119.6	119.8	108.0	108.4	111.1	112.0	129.3	128.6	114.4	114.2
November	120.1	120.1	108.3	108.7	111.6	112.3	129.9	129.1	114.7	114.5
December	120.7	120.6	108.6	109.0	112.0	112.7	130.5	129.6	114.9	114.8
January 1988	121.1	121.0	108.8	109.3	112.4	113.1	131.1	130.1	115.1	115.1
February	121.5	121.5	109.0	109.7	112.7	113.5	131.6	130.7	115.3	115.3
March	122.0	122.0	109.3	109.9	113.1	113.9	132.1	131.2	115.6	115.6

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	-14.71	-12.06	180.4	180.0	4250	4246	3696	3692	-6.3	-6.3
November	-19.22	-19.22	182.5	181.4	4268	4262	3702	3700	-9.4	-9.0
December	-11.65	-10.66	184.1	185.6	4287	4274	3708	3704	-11.3	-9.6
January 1987	-15.25	-14.78p	182.9	183.8	4309	4305	3711	3714	-16.3	-13.5
February	-14.37	-14.05	183.4	184.9	4347	4339	3728	3731	-20.5	-16.2
March	-13.79	-13.56	183.0	184.2	4380	4365	3740	3747	-23.9	-12.8
April	-14.88	-13.92	183.9	184.5	4396	4388	3744	3753	-7.3	-14.3
May	-14.55	-13.55	184.3	183.7	4413	4406	3753	3756	-1.4	-11.6
June	-13.95	-13.41	184.8	184.3	4430	4424	3767	3759	-4.8	-9.5
July	-14.43	-12.86	185.1	184.9	4449	4445	3770	3764	-5.9	-8.4
August	-14.41	-13.05	184.7	184.8	4468	4467	3770	3770	-7.0	-7.3
September	-13.59	-13.42	184.2	184.3	4486	4495	3773	3777	-8.1	-8.8
October	-13.92	-12.96	183.6	183.9	4507	4523	3784	3788	-11.6	-10.2
November	-13.44	-12.78	183.1	184.5	4533	4542	3799	3791	-14.3	-13.5
December	-13.03	-12.71	183.7	184.7	4560	4569	3813	3801	-17.0	-15.6
January 1988	-14.43	-11.43	184.4	185.3	4581	4598	3814	3809	-16.3	-13.9
February	-14.02	-11.86	184.9	185.0	4600	4620	3811	3815	-15.8	-15.1
March	-13.90	-11.59	184.3	184.6	4619	4640	3808	3819	-15.4	-15.6

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	250.8	250.8	701.2	701.4	2765.2	2760.3	5.85	5.85	5.26	5.26
November	252.9	252.8	713.5	712.4	2781.4	2774.3	6.04	6.04	5.41	5.41
December	254.9	255.3	730.4	730.4	2804.3	2797.8	6.91	6.91	5.55	5.55
January 1987	257.3	258.8	735.3	737.6	2826.5	2819.0	6.15	6.15	5.47	5.43
February	259.2	259.3*	738.4	737.0*	2841.6	2823.2*	6.22	6.21*	5.43	5.52*
March	261.1	260.4	744.5	740.8	2856.8	2837.8	6.02	6.15	5.45	5.46
April	262.5	261.9	750.6	745.1	2873.4	2854.3	5.64	5.93	5.33	5.40
May	264.0	263.3	755.3	747.8	2895.5	2871.4	5.53	5.78	5.25	5.28
June	265.6	264.9	759.9	752.3	2917.3	2891.5	5.51	5.84	5.18	5.33
July	267.4	266.3	765.3	755.8	2932.4	2911.7	5.27	5.78	5.03	5.37
August	269.1	267.8	771.0	760.6	2945.6	2932.1	5.34	5.85	5.09	5.42
September	270.8	269.1	776.8	764.2	2958.1	2952.6	5.53	5.98	5.15	5.48
October	272.2	270.5	780.1	767.7	2976.4	2973.3	5.82	6.15	5.37	5.69
November	273.9	272.2	783.4	772.0	2997.9	2994.1	5.93	6.23	5.42	5.78
December	275.5	273.8	786.8	777.6	3018.8	3015.8	6.03	6.28	5.48	5.83
January 1988	276.9	275.2	791.2	782.1	3034.6	3033.3	6.15	6.25	5.53	5.80
February	278.9	276.6	795.1	785.8	3049.1	3051.5	6.19	6.37	5.60	5.85
March	280.8	278.3	799.0	790.9	3064.0	3067.3	6.18	6.42	5.56	5.94

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	8.86	8.86	7.08	7.08	5.68	5.68	5.69	5.69	7.50	7.50
November	8.68	8.68	6.85	6.85	5.76	5.76	5.76	5.76	7.50	7.50
December	8.49	8.49	6.86	6.86	6.10	6.10	6.04	6.04	7.50	7.50
January 1987	8.46	8.38	6.53	6.53	6.10	5.85	6.05	5.87	7.50	7.50
February	8.55	8.49*	6.67	6.54*	6.13	6.10	6.15	6.17	7.50	7.50*
March	8.51	8.46	6.62	6.51	6.00	6.07	6.07	6.14	7.50	7.50
April	8.43	8.37	6.53	6.45	5.56	5.86	5.63	6.01	7.50	7.50
May	8.41	8.35	6.50	6.42	5.43	5.69	5.52	5.83	7.50	7.50
June	8.29	8.42	6.43	6.49	5.28	5.75	5.35	5.87	7.29	7.50
July	8.25	8.46	6.37	6.53	5.20	5.72	5.29	5.85	7.00	7.50
August	8.37	8.51	6.49	6.58	5.29	5.80	5.34	5.91	7.00	7.50
September	8.49	8.55	6.61	6.63	5.52	6.11	5.63	6.23	7.48	7.50
October	8.75	8.73	6.84	6.77	5.78	6.17	5.89	6.28	7.50	7.86
November	8.85	8.89	6.93	6.92	5.93	6.27	5.98	6.36	7.61	8.00
December	8.92	8.96	7.00	6.99	6.05	6.32	6.19	6.43	7.75	8.00
January 1988	9.03	9.14	7.12	7.15	6.17	6.26	6.31	6.40	7.75	8.00
February	8.90	9.11	6.99	7.13	6.22	6.38	6.37	6.47	7.75	8.00
March	8.92	9.12	7.01	7.15	6.20	6.43	6.33	6.55	7.75	8.12

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

4/24/87 U1880-3

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MONTHLY PROJECTIONS March 1987

Dr. Donald Ratajczak, Director
For Release: April 8, 1987

WHEN WILL DOLLAR SLIDE END?

When changes in currency values are adjusted for changes in inflation rates, the dollar's slide against the Japanese yen appears to be overdone. Parity also appears to have been attained with the European currencies. Of course, the dollar appears overvalued against the Taiwan dollar and the Korean wan, and these countries are continuing to sharply increase their trade surpluses. In the case of Korea, which accumulated significant foreign debt because of earlier foreign exchange borrowings, the resulting current account surpluses are returning that country to international financial health. Taiwan, on the other hand, is a greater creditor nation per capita than Japan. As such, the Taiwanese policy of continuing to derive economic strength through export expansion no longer is in the best long-term interests of the world economy. However, the dollar's continuing weakness is not against those countries with which it remains overvalued, but with Japan. (The dollar against the German mark, in comparison, has not weakened depreciably in the past few months.)

Apparently, the weakness against Japan is the result of a differential in the production costs of export-oriented industries relative to other industries in Japan. Therefore, a measure of inflationary differentials between the two countries simply is inadequate to measure the differences in competitive pressures among countries engaged in international trade. In order to achieve cost balance with the Japanese export industries, the yen would need to rise until only 125 would be needed to purchase a dollar. However, such calculations are based upon the assumption that domestic cost pressures are unaffected by the change in currency values. In fact, the dollar has now fallen sufficiently to begin generating increasing inflationary pressures in the United States. These could begin increasing cost pressures domestically. If so, the dollar could continue to fall significantly against Japanese currency and begin falling once again against European currencies in the months ahead.

At the same time, the yen's strength against the dollar also has been increasing the yen against currencies of other Pacific-Rim countries. This has basically eliminated Japanese competitiveness in many of those countries. A recession in Japan may soon develop because of this weakness. Such recessionary pressures, in turn, could exert downward cost pressures upon Japanese industry. Similarly, the European currencies are beginning to slow their economies. Wage pressures may begin modifying in those countries as well. Also, many raw materials are priced in dollars. The net effect of this will be to continue causing downward cost pressures in Europe and Japan. Thus, stability of the dollar will depend upon whether the differential cost pressures begin to change more dramatically or more slowly than the change in currency values. In any event, the dollar has reached a point that is beginning to effect differential cost pressures and therefore is reducing the stabilization effects that a declining currency otherwise would generate.

Most troublesome in the dollar's most recent decline is the increase in commodity prices. After stabilizing for more than two months, the crude material prices covered by the Journal of Commerce, have again reached a new high. Crude material prices, excluding energy and foodstuffs in the PPI, have been growing significantly for the past six months. As these price pressures persist, increasing costs of industrial materials soon will begin to develop. Pressures already appear to be surfacing for chemicals and paper product. Some nonferrous metals are also showing significant price increases, with a significant price spurt developing in the silver prices. As industrial material prices intensify, purchasing agents will begin to increase their inventory holdings. This, in turn, will generate more demand. It might also increase inventory investment and raise industrial activity.

No adjustments have yet been made to our inflation or production outlook to account for these currency-induced inflationary and industrial activity changes. In fact, manufacturing inventories declined slightly in February following a significant expansion in January. Thus, any desire to raise inventory holdings is not significant at the present time.

However, increasing inflationary pressures and the threat of increasing economic activity have combined to raise short-term credit market pressures. Also, the Federal Reserve has been slightly reluctant to accommodate this increased credit market activity because of the dollar's weakness and the rise in commodity prices.

The dollar's weakness has also had an indirect effect upon interest rate pressures. Many foreign investors now view American assets as relatively cheap in comparison to assets in their own countries. As a result, they have been aggressively purchasing American stocks. This has aided the explosive rally in equity values. This rally, in turn, has enticed IRA deposits out of bank certificates and into self-directed brokerage accounts. During the first two months of this year, only 29% of additional IRA monies were assumed to be flowing into traditional bank channels. This has caused the banks to bid more aggressively for funds in the open market. The result has been a relatively high rate on certificates of deposit. Indeed, the increased cost of acquiring funds in the open market appears to be behind the recent 0.25% increase in the prime rate. As many of these IRA investment decisions will diminish after April 15, borrowing pressures upon the banks may also begin diminishing unless inventory investments remain strong.

On the other hand, the reduction in IRA activity after April 15 could diminish funds flowing into the stock market. However, many analysts probably have overstated the significance of IRA investments upon stock market movements. Because of stronger gains in blue chips than in the broad market, it appears that much of the investment activity has come from abroad. Thus, the foreign connection rather than an IRA effect appears to be the dominant force in pressuring equity values upward at the present time.

Thus far, foreign investors have not been terribly disappointed in their American investments. Although the dollar has fallen significantly in value, equity markets have increased significantly. The total rates of return to foreign investors remain acceptable. Moreover, as the dollar continues to fall, some foreign investors begin to believe that further declines in the dollar's value cannot be great. Recently, however, Japanese investors have become discouraged upon the near-term prospects of the dollar and have been selling some of their fixed instruments. This has raised some fear that the Japanese will not be bidding for their more than one-third of ten and thirty-year government bonds when the quarterly funding arrives in early May. Some concerns have led to increasing interest rates for long-term instruments.

Quarterly Profile of GNP

	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1987 Annual</u>
Real:	1.1	3.5	2.6	1.8	2.4	1.8	2.3
Price:	0.7	5.0	4.2	4.8	4.4	5.1	3.5
Nominal:	1.7	8.5	6.9	6.7	6.9	7.0	5.9

Monthly Statistical Highlights for March 1987

Personal income +0.0%; savings rate 3.3%; personal consumption +0.4%; retail sales +0.2%; housing starts -2.8%; housing permits -2.3%; construction expenditures -1.1%; business inventories +0.3%; orders for durable goods +0.6%; orders for nondefense capital goods -1.0%; industrial production -0.4%; CPI +0.3%; PPI +0.3%; consumption deflator +0.3%; leading indicator -0.2%; real GNP +2.6%; M1 5.7%; M2 3.7%.

Monthly Statistical Highlights for April 1987

Payroll employment +180,000; index of hours worked +0.2%; household employment +216,000; civilian unemployment rate 6.6%; personal income +0.5%; savings rate 3.2%; personal consumption +0.8%; retail sales +1.0%; auto sales 10.2 million units; housing starts -1.2%; housing permits -1.8%; construction expenditures -0.4%; business inventories +0.2%; orders for durable goods +1.4%; orders for nondefense capital goods +0.8%; industrial production +0.3%; CPI +0.4%; PPI +0.5%; consumption deflator +0.2%; leading indicator +0.3%; real GNP 2.6%; M1 +6.2%; M2 +6.1%.

Commentary

Employment - Employment statistics for March clearly suggest that February's strong gains were an aberration. Indeed, the hours worked in manufacturing shows a modest increase between December and March except for the spike up in February. Snowstorms in the East late in January may have created an unintended backlog, especially by manufacturers. As a result, they probably were working overtime in February in order to eliminate the order problem. In March, activity apparently has settled down. In addition, the unusually mild winter led to unseasonably strong construction activity. A return to more normal weather conditions in March caused a reversal in that sector. More significantly, the service sector appears to be slowing down. Excluding a 60,000 increase in government payrolls, the service economy would have expanded only slightly more than 100,000. It is clear that the government gains will not be repeated in the next few months. Thus, another month of sluggish activity is anticipated with much of the slowing occurring in reduced growth for the service components.

The hourly earnings index showed a 0.3% monthly gain but remained only 2.0% above previous year levels. There appears to be little evidence of any acceleration in wage pressures at the present time. Apparently, relatively high unemployment rates, the threat of foreign competition, and a recent history of moderate inflation have combined to hold down wage demands. It is also noteworthy that the labor force is beginning to slow noticeably, especially for teenagers and women. As a result, real growth in excess of 2.5% appears to be sufficient to reduce the unemployment rate. However, the dip in the unemployment rate in March was mostly a statistical artifact, as the labor force declined substantially in that month.

The diffusion index was surprisingly weak, at less than 50% in March, but this probably also reflects the unusually strong and temporary nature of increased industrial activity in February.

Personal Income and Outlays - The decline in the work week appears to be more than sufficient to offset a modest increase in hourly wages. As a result, there should be no gains in wage income in March. Also, the significant rebound in farm income in February was the result of significant expansion of commodity credit subsidies. These subsidies probably will not increase in March. A decline in property income will probably continue to develop, leading to virtually no change in personal income during the month. The unusually low savings rate may remain for some time. First, the personal income data has caused a more dramatic decline in tax liabilities early in the year than subsequently will develop. This leads to higher savings early in the year followed by reduced savings later. However, the most significant factor causing lower savings rates may be substantial gains in stock market values. People may be increasing their consumption spending because of the increased value of their wealth holdings. Thus, unusually low savings rates probably will persist until the stock market rally ends.

Automobile incentives appear to have maintained unit sales through March. Indeed, incentives now appear to be continuing through April and should lead to slightly higher unit sales in that month as well. Of course, this will have minimal effect upon changes in retail sales activity in March. However, a modest further price increase for nondurables along with some continuing gains in department store activity should lead to a relatively modest growth in overall

retail sales activity. Unfortunately, the shifting of the Easter season makes seasonals on retail trade components unusually suspect between March and April. The results of this modest increase in retail activity will be a modest growth in consumption expenditures. The service component increased sharply in February as a result of imputive financial services. Stock market activity was slightly more subdued through much of March and should lead to more modest gains in the service component during that month. A spurt in activity then should lead to growing expenditures in April.

Construction - Weather appears to be the major factor associated with the unusually high single-family starts early in 1987. Housing sales have not been robust. Single-family sales of new units are down early in the year and more than a seven-month supply of housing currently is available. As weather becomes less substantial, housing starts should significantly slow in the months ahead. Multi-family starts already have fallen to nearly 500,000 units. They should hover between 480,000 and 500,000 units for the next two years. Permits have been usually strong, but these gains probably are the result of builders finding unusually favorable weather and initiating projects early.

A return to more normal weather should be especially obvious in construction expenditures. Nonresidential activity, which rebounded in February should resume its downward path in March. A jump in public construction in February also appears to be weather-related. However, the recently enacted highway bill ensures higher levels of public construction over the next year than originally projected. Winter weather also has increased the amount of residential construction activity that should prevail early this year. Thus, the correction in construction activity will be more gradual and persist longer than previously anticipated.

Lumber prices appear to be largely responsible for the modest uptick in construction prices during February. However, the weakness in construction activity certainly is restraining changes in construction inflation. Also, better data sources led to a downward revision in the deflator and an upward revision in real construction activity over the past year.

Business Activity - Manufacturing inventories again weakened in February following their January surge. Part of this weakness may have been the result of increased economic activity. Possibly, the snows prevented some products from being completed in January. If so, the February decline in manufacturing inventories will prove to be temporary. Nevertheless, they will restrain the growth of business inventories in that month.

Orders rebounded sharply in February, possibly because the sales force in the East was able to engage in more productive days than in the month before. This also could indicate a slight upward blip that won't be sustained. Furthermore, the orders are not high relative to shipments. Orders and shipments are identical for nondefense capital goods. There is little reason to expect significant expansion in shipments of capital goods in the months ahead. Also, a sharp increase in defense orders still left orders nearly \$2 billion behind shipments. Moreover, defense shipments have generally been growing if that December aberration can be excluded. However, defense authorizations approved by the Congress have been stable for the past few years. Thus, a significant slowing in defense shipments probably will materialize later this year.

Industrial production figures probably were as distorted by the weather as those of employment and manufacturing. Thus, the rebound in February should not have been as significant. On the other hand, the distortion will not be as large as for employment figures. Therefore, the decline in industrial production implied by the employment statistics appears to be larger than will actually materialize. Nevertheless, automobiles were assembled at an 8.3 million unit rate in February and probably will be assembled at somewhere between 7.5 and 7.7 million units in March. This leads to a 0.5% decline in consumer goods. A comparable decline in business materials could materialize, leading to the sharp dip in activity in March.

Prices - Energy prices will not be a significant factor in inflation rates during the next several months. However, our forecast assumes that prices would fall once the heating season is over. Obviously, Saudi Arabia's choice to become a swing producer has eliminated any downward pressures upon oil at this time. This is the major reason leading to higher inflation estimates for industrial commodities and the CPI than in our February forecast. The slowing in prices of finished goods appears to be the result of closer examination of food prices for the year. Grocery store prices are now expected to expand slightly more than 3%. Prices of imported goods are expected to increase more substantially. While the PPI is a domestic price index, it appears that our forecasted values for February were too high.

Our estimated increases in the GNP deflator are leading to slower rates of growth for real economic activity than had been anticipated. Much of this acceleration in the deflator is the result of higher energy prices than originally anticipated. However, higher import prices do not have the same effect upon the GNP deflator, since import prices lead to a GNP offset that is not captured in other price indices, while imported goods remain in inventory. Therefore, there will be a slight downward trend.

Miscellaneous - The work week declined significantly in March and should lead to a decline in the leading indicator despite another significant positive contribution from rising stock prices. The decline in M2 during February led to a decline in the impact of real money balances upon the leading indicator which was offset by strong growth in orders. Orders should also weaken in March, causing the overall leading indicator to decline. However, the leading indicators are significantly above levels that had been anticipated in our February forecast.

Financial Markets

The surprising 0.25 percentage point increase in the prime rate appears to be an attempt by the banking industry to re-establish normal spreads between the cost of funds and the yield on their loan portfolios. Much of the deterioration in these spreads occurred in January, but the banks were reluctant to make a prime rate move without evidence that the Federal Reserve was tolerating higher federal funds rates. The Federal Reserve never openly indicated that a higher federal funds target was desired, but the continued performance of federal funds in excess of 6% led to the conclusion that such an increase was not at odds with Federal Reserve policy. Also, a strong stock market may have diverted certificates of deposit from IRA investments in banks to self-directed accounts in brokerage firms. The net result of this was to cause banks more aggressively to

seek funds through certificates of deposit. This caused upward pressures upon those deposits, leading to a narrowing of the spreads. For example, certificates of deposit averaged slightly more than 5.8% during the fourth quarter but had drifted up to an average of 6.15%, a 35 basis-point gain without any adjustment in the prime rate.

As inflationary pressures slowly intensify and inventories once again build up, short-term interest rate pressures should gradually intensify. No dramatic increase in short-term rates is anticipated but the previous modest weakness in rates that was expected in our February forecast simply must be thrown out. These upward pressures upon borrowing costs will lead to further modest increases in the prime rate during the next twelve months.

Long-term interest rates are expected to respond unfavorably to these changing short-term rates. However, the municipals market also has experienced a glut of supply that has led to higher yields in that market relative to the taxable market. These relatively higher yields are expected to persist through the year.

Equity Markets - The equity markets weathered upward pressures upon the prime rate with surprising ease. Indeed, the equity markets now are moving in the opposite direction to changes in interest rates. This is an anomalous performance that cannot persist indefinitely. While operating profits probably are improving slightly as a result of further weakness in the dollar, it is unlikely that they will expand more than 10% in 1987. However, most equity values have increased more than 25% since the first of this year. Further interest rate increases probably will be required before this equity market ultimately reaches its peak. These increasing interest rate pressures may very well materialize during the summer. Thus, a stock market correction probably is in the cards for the second half of this year.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	100826	100826	118.6	118.6	110192	110192	6.9	6.9	170.0	170.0
November	101065	101068	119.3	119.3	110432	110432	6.9	6.9	170.9	170.8
December	101334	101322	119.0	119.0	110637	110637	6.7	6.7	170.8	170.6
January 1987	101542	101626	119.5	119.9	110857	111011	6.7	6.7	171.2	170.7
February	101770	101862	119.8	120.9	111092	111382	6.7	6.7	171.6	171.4
March	102010	102026	120.2	120.4	111582	111368	6.6	6.6	172.0	171.8
April	102197	102206*	120.4	120.6*	111723	111584*	6.6	6.6*	172.3	172.2*
May	102378	102375	120.6	120.8	111892	111777	6.6	6.6	172.6	172.5
June	102583	102592	120.8	121.0	111794	112005	6.6	6.6	172.8	172.9
July	102769	102753	121.0	121.1	112093	112199	6.6	6.6	173.2	173.2
August	102979	102946	121.3	121.4	112406	112412	6.7	6.6	173.7	173.6
September	103188	103127	121.5	121.6	112725	112570	6.6	6.6	174.1	174.1
October	103356	103316	121.7	121.8	112846	112782	6.5	6.6	174.5	174.5
November	103532	103501	121.9	121.9	113009	113015	6.5	6.5	174.8	175.0
December	103690	103762	122.1	122.2	113205	113313	6.4	6.4	175.1	175.4
January 1988	103857	103914	122.3	122.4	113398	113480	6.4	6.4	175.9	175.9
February	104060	104117	122.5	122.6	113587	113781	6.4	6.3	176.7	176.6
March	104188	104284	122.6	122.7	113773	114048	6.4	6.3	177.4	177.2

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	3.519	3.518	2.102	2.102	102.8	93.4	2.991	2.989	2.888	2.896
November	3.527	3.523	2.112	2.112	88.2	92.7	2.994	2.990	2.905	2.897
December	3.555	3.543	2.119	2.115	55.7	36.6	3.019	3.000	2.963	2.963
January 1987	3.560	3.549	2.133	2.128	139.3	120.5	3.059	3.026	2.920	2.905
February	3.574	3.581	2.145	2.146	119.4	109.1	3.067	3.063	2.948	2.954
March	3.588	3.582*	2.157	2.147*	106.7	101.5*	3.075	3.067*	2.968	2.966*
April	3.602	3.599	2.165	2.158	108.5	97.2	3.092	3.085	2.984	2.988
May	3.617	3.613	2.173	2.166	108.3	91.6	3.104	3.095	2.996	3.003
June	3.633	3.630	2.180	2.177	111.3	93.2	3.117	3.108	3.006	3.015
July	3.647	3.643	2.191	2.184	103.9	88.2	3.125	3.117	3.021	3.029
August	3.661	3.661	2.203	2.196	91.6	87.5	3.133	3.131	3.041	3.044
September	3.675	3.678	2.215	2.207	79.7	73.7	3.141	3.144	3.061	3.070
October	3.695	3.695	2.222	2.218	84.4	77.0	3.156	3.157	3.072	3.080
November	3.704	3.709	2.231	2.227	75.1	69.9	3.161	3.167	3.086	3.097
December	3.734	3.730	2.240	2.240	87.7	74.2	3.186	3.184	3.098	3.110
January 1988	3.739	3.739	2.254	2.251	104.0	89.4	3.219	3.214	3.115	3.125
February	3.760	3.762	2.262	2.266	106.6	102.5	3.236	3.240	3.129	3.138
March	3.783	3.778	2.270	2.277	110.4	108.6	3.255	3.258	3.145	3.149

Fore. = February Forecast

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CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	2789.4	2797.4	391.3	396.8	934.3	934.6	1463.8	1466.0	2423.8	2430.2
November	2806.5	2798.8	386.9	381.2	939.4	938.0	1480.3	1479.5	2432.7	2427.6
December	2863.8	2865.2	434.4	431.4	946.4	947.6	1483.0	1486.1	2478.8	2479.6
January 1987	2820.0	2806.8	375.6	361.7	950.3	947.9	1494.1	1497.2	2428.9	2409.7
February	2846.8	2855.9	386.5	386.5	955.8	958.6	1504.5	1510.8	2439.4	2443.7*
March	2866.7	2866.9*	390.5	385.4*	961.2	963.2*	1515.0	1518.3*	2443.9	2443.9
April	2881.2	2888.9	392.7	393.8	964.8	966.4	1523.7	1528.7	2452.1	2459.5
May	2892.8	2904.1	394.9	394.9	965.9	969.8	1532.0	1539.4	2455.7	2455.6
June	2902.2	2915.1	395.6	393.1	966.3	973.3	1540.3	1548.7	2457.4	2454.5
July	2916.8	2928.7	395.1	393.5	970.6	977.3	1551.1	1557.9	2463.5	2456.7
August	2936.3	2942.9	400.3	394.9	974.7	987.2	1561.3	1566.8	2471.6	2459.5
September	2955.4	2969.3	404.6	406.9	978.8	985.5	1572.0	1576.9	2479.4	2474.5
October	2964.9	2978.5	401.5	401.7	983.0	989.2	1580.4	1587.6	2479.0	2470.3
November	2978.6	2995.0	403.8	403.0	986.7	992.6	1588.1	1599.4	2480.1	2474.7
December	2990.3	3007.2	404.0	403.4	990.5	996.3	1595.8	1607.5	2477.5	2474.8
January 1988	3006.2	3021.4	405.6	404.6	994.3	1000.5	1606.3	1616.3	2482.4	2474.7
February	3019.8	3033.7	404.9	405.5	997.1	1003.5	1617.8	1624.7	2485.4	2474.4
March	3034.4	3044.9	405.1	405.0	1000.0	1006.1	1629.3	1633.8	2487.2	2470.1

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	121.66	121.66	19.25	19.25	10.3	10.3	73.98	73.98	28.44	28.44
November	120.94	121.06	19.25	19.27	10.5	10.5	74.23	74.04	27.46	27.75
December	126.26	126.94	19.53	19.67	13.6	13.6	74.81	74.75	31.92	32.52
January 1987	120.53	117.52	19.46	19.41	8.8	8.3	75.23	74.59	25.84	23.52
February	121.13	122.29	19.32	19.80	9.3	9.9	75.56	75.58	26.25	26.91
March	122.60	122.54*	19.30	19.63*	9.7	9.9*	75.92	75.96*	27.38	26.95*
April	122.86	123.82	19.35	19.82	9.9	10.2	76.21	76.23	27.30	27.77
May	123.39	124.24	19.40	19.88	10.1	10.2	76.35	76.51	27.64	27.85
June	123.88	124.31	19.47	20.05	10.2	10.0	76.49	76.80	27.92	27.46
July	124.33	124.69	19.50	19.88	10.1	10.1	76.73	77.13	28.10	27.68
August	125.02	125.19	19.56	19.93	10.2	10.1	77.08	77.46	28.38	27.80
September	125.32	126.98	19.53	20.04	10.2	10.5	77.42	77.81	28.37	29.13
October	125.98	126.67	19.58	20.16	10.2	10.2	77.72	78.12	28.68	28.39
November	126.54	127.10	19.55	20.05	10.3	10.3	78.03	78.40	28.96	28.65
December	126.80	127.46	19.50	20.24	10.3	10.2	78.35	78.71	28.95	28.51
January 1988	127.09	127.96	19.57	20.11	10.3	10.3	78.52	79.06	29.00	28.79
February	127.22	128.32	19.64	20.18	10.2	10.3	78.86	79.31	28.72	28.83
March	127.75	128.48	19.71	20.21	10.2	10.2	79.20	79.53	28.84	28.74

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CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	1.628	1.657	1.085	1.114	1.565	1.565	379.7	388.5	338.1	348.6
November	1.585	1.637	1.087	1.129	1.613	1.613	377.0	383.1	335.3	345.5
December	1.802	1.813	1.209	1.223	1.893	1.910	380.3	378.5	338.0	341.7
January 1987	1.613	1.804	1.088	1.247	1.496	1.690	380.7	374.8	337.8	339.0
February	1.597	1.851	1.075	1.317	1.523	1.764	375.4	378.4	332.2	341.3
March	1.610	1.799*	1.091	1.283*	1.516	1.723*	374.7	374.4*	331.0	337.0*
April	1.633	1.777	1.103	1.256	1.534	1.692	375.6	373.0	331.2	335.1
May	1.641	1.719	1.110	1.213	1.556	1.643	376.4	374.4	331.6	335.5
June	1.641	1.701	1.111	1.187	1.550	1.607	377.7	373.1	332.8	333.7
July	1.631	1.691	1.122	1.165	1.542	1.588	376.8	372.3	331.4	332.7
August	1.620	1.642	1.115	1.136	1.533	1.553	377.3	371.1	331.0	331.6
September	1.621	1.615	1.120	1.114	1.519	1.492	376.8	370.3	329.7	330.3
October	1.626	1.605	1.126	1.092	1.533	1.498	376.0	370.1	328.7	329.6
November	1.609	1.596	1.113	1.083	1.516	1.476	375.9	368.5	327.7	327.6
December	1.621	1.597	1.129	1.095	1.518	1.485	376.5	368.2	327.7	327.0
January 1988	1.621	1.581	1.116	1.082	1.524	1.489	376.8	368.8	327.4	326.7
February	1.636	1.566	1.125	1.063	1.518	1.482	376.7	368.8	326.7	326.1
March	1.623	1.594	1.120	1.078	1.522	1.503	378.4	368.7	327.3	326.0

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	129.1	133.4	71.9	73.2	178.6	181.9
November	128.2	129.4	70.7	71.5	178.0	182.2
December	128.5	126.9	72.2	73.0	179.6	178.6
January 1987	128.6	118.2	72.5	75.1	179.6	181.5
February	127.8	121.0	71.8	78.0	175.8	179.4
March	127.0	118.1*	71.0	75.1*	176.7	181.2*
April	126.8	115.6	72.3	75.3	176.5	182.1
May	126.5	115.9	73.7	75.6	176.2	182.9
June	126.4	115.3	75.1	76.1	176.2	181.7
July	126.6	115.0	74.6	76.4	175.6	180.9
August	126.8	114.6	75.1	76.9	175.4	179.6
September	126.8	114.9	74.9	77.1	175.1	178.3
October	127.5	115.3	73.9	77.5	174.6	177.3
November	128.2	115.1	73.6	77.3	174.1	176.1
December	129.0	115.4	73.8	77.6	173.7	175.2
January 1988	128.0	115.8	74.3	78.0	174.5	175.0
February	126.5	116.2	74.9	78.2	175.3	174.4
March	126.8	116.6	75.6	78.3	176.0	173.8

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BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	276.0	320.8	103.57	97.68	26.91	26.56	27.72	27.86
November	276.6	321.1	109.27	103.52	28.65	28.03	27.91	27.55
December	275.3	318.2	106.94	105.97	27.74	29.31	28.23	28.73
January 1987	277.8	320.7	103.46	95.55	26.43	26.78	27.06	25.84
February	279.5	320.4	105.92	101.94	27.17	26.81	27.11	26.81
March	279.3	321.0*	106.42	102.54*	27.61	26.41*	27.56	26.53*
April	280.9	321.7	107.72	103.95	28.13	27.03	27.94	26.73
May	282.0	322.5	107.93	104.46	28.52	27.26	28.06	27.04
June	283.0	323.5	106.85	103.25	28.35	27.09	28.04	27.11
July	284.2	324.5	106.14	103.51	28.05	27.03	28.17	27.17
August	285.5	326.0	106.26	103.46	28.19	27.16	28.26	27.24
September	286.5	327.7	106.52	104.48	28.32	27.31	28.35	27.35
October	288.1	328.6	107.83	104.95	28.86	27.52	28.57	27.51
November	289.8	329.6	108.84	106.17	29.03	27.85	28.75	27.68
December	291.1	331.2	110.23	108.41	29.62	28.06	28.93	27.89
January 1988	292.7	332.8	106.92	103.82	27.46	27.28	28.56	27.46
February	294.0	334.5	108.25	104.16	28.05	27.43	28.82	27.49
March	295.0	336.4	108.59	103.89	28.46	27.31	29.00	27.48

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	591.6	591.6	8.01	8.15	125.3	125.3	79.0	79.0
November	590.6	590.1	8.69	8.93	126.0	126.0	79.4	79.4
December	590.5	586.6	8.43	10.66	126.6	126.6	79.6	79.6
January 1987	593.7	592.2	8.46	8.28	126.9	126.8	79.7	79.6
February	597.5	593.4*	8.59	8.40	127.1	127.3	79.9	79.8
March	597.9	594.9	8.73	8.32*	127.4	126.8*	79.9	79.3*
April	599.4	596.2	8.56	8.48	127.6	127.2	79.9	79.5
May	602.2	597.9	8.82	8.63	127.8	127.4	79.9	79.5
June	604.8	600.4	8.87	8.69	128.1	127.7	80.0	79.6
July	607.3	603.4	8.83	8.75	128.1	127.6	79.8	79.3
August	609.5	606.1	8.76	8.66	128.2	127.9	79.7	79.4
September	611.4	609.1	9.36	9.14	128.7	128.1	79.9	79.4
October	614.2	611.1	8.92	8.57	129.2	128.5	80.2	79.6
November	618.3	613.0	8.95	8.74	129.6	128.7	80.3	79.6
December	621.0	616.0	9.00	8.80	129.8	128.8	80.3	79.5
January 1988	624.6	619.7	9.12	8.66	130.0	129.0	80.3	79.5
February	626.9	622.9	9.16	8.81	130.0	129.3	80.1	79.6
March	628.6	626.5	9.21	8.94	130.1	129.5	80.0	79.6

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PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	329.8	330.0	290.3	289.9	309.3	309.3	115.0	115.0
November	330.7	330.8	290.9	290.2	309.6	309.6	115.3	115.2
December	331.5	331.4	290.9	289.9	309.3	309.3	115.6	115.4
January 1987	333.0	333.6	291.8	291.7	312.3	313.6	116.1	116.2
February	334.7	334.9	294.0	292.0	314.7	315.7	116.6	116.6
March	335.5	335.9*	295.1	292.9*	316.5	316.0*	117.1	117.0*
April	336.2	337.2	295.6	294.3	314.7	316.4	117.4	117.2
May	337.0	339.0	296.2	294.9	312.8	317.2	117.6	117.9
June	338.7	340.4	296.8	295.4	312.4	317.9	117.6	118.4
July	339.5	341.5	297.5	296.0	313.0	318.4	118.0	118.8
August	340.1	342.9	298.2	296.6	314.3	318.9	118.5	119.2
September	340.7	343.7	298.9	297.3	312.9	316.8	118.9	119.5
October	341.9	345.4	300.0	297.8	315.7	320.2	119.1	120.0
November	343.4	346.5	301.0	298.2	316.1	320.9	119.3	120.5
December	345.0	347.9	302.1	298.8	316.5	321.8	119.6	120.9
January 1988	346.0	349.6	303.1	300.1	318.3	323.3	120.1	121.5
February	347.0	351.0	304.2	301.0	320.2	325.4	120.7	121.9
March	348.1	353.0	305.4	301.8	322.0	326.8	121.3	122.5

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	115.1	115.1	105.4	105.6	107.1	107.1	124.0	124.0	112.3	111.4
November	115.4	115.3	105.7	105.3	107.3	107.3	124.3	124.2	112.4	110.9
December	115.5	115.6	106.5	106.9	107.5	107.9	124.5	124.1	112.5	110.8
January 1987	116.1	116.5	106.0	106.0	108.3	109.2	125.0	124.7	112.7	110.6
February	116.7	116.9*	106.2	105.7*	109.1	109.9*	125.5	125.3*	113.0	110.9
March	117.3	117.3	106.5	106.0	109.6	110.4	126.1	125.7	113.2	111.1*
April	117.5	117.5	106.7	106.7	109.8	111.0	126.6	126.2	113.4	111.3
May	117.8	118.3	106.9	107.0	109.8	111.4	126.9	126.6	113.5	111.6
June	118.1	118.8	107.2	107.3	109.9	111.8	127.3	127.2	113.5	111.8
July	118.4	119.2	107.4	107.6	110.1	112.2	127.9	127.7	113.7	111.9
August	118.8	119.7	107.6	107.9	110.4	112.6	128.4	128.2	114.0	111.9
September	119.2	120.0	107.8	107.9	110.7	113.0	128.8	128.7	114.3	112.1
October	119.6	120.6	108.0	108.2	111.1	113.3	129.3	129.5	114.4	112.3
November	120.1	121.0	108.3	108.5	111.6	113.7	129.9	130.0	114.7	112.5
December	120.7	121.5	108.6	108.8	112.0	114.1	130.5	130.6	114.9	112.6
January 1988	121.1	122.1	108.8	109.1	112.4	114.5	131.1	131.4	115.1	112.9
February	121.5	122.6	109.0	109.4	112.7	115.0	131.6	132.1	115.3	113.1
March	122.0	123.3	109.3	109.6	113.1	115.6	132.1	132.8	115.6	113.1

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	-14.71	-12.06	180.4	180.9	4250	4246	3696	3692	-6.3	-6.3
November	-19.22	-19.22	182.5	182.5	4268	4260	3702	3698	-9.4	-9.0
December	-11.66	-10.66	184.1	186.8	4287	4270	3708	3700	-11.3	-9.3
January 1987	-15.25	-14.78	182.9	185.8	4309	4308	3711	3707	-16.3	-13.5
February	-14.37	-15.57p	183.4	187.1	4347	4349	3728	3730	-20.5	-17.6
March	-13.79	-14.21*	183.0	186.7*	4380	4373	3740	3738	-23.9	-15.4
April	-14.88	-14.26	183.9	187.2	4396	4390	3744	3746	-7.3	-12.1
May	-14.55	-14.03	184.3	187.6	4413	4420	3753	3749	-1.4	-7.3
June	-13.95	-13.65	184.8	187.0	4430	4443	3767	3753	-4.8	-6.5
July	-14.43	-13.72	185.1	187.1	4449	4464	3770	3758	-5.9	-6.8
August	-14.41	-13.36	184.7	187.3	4468	4480	3770	3758	-7.0	-7.2
September	-13.59	-13.55	184.2	187.7	4486	4504	3773	3769	-8.1	-7.9
October	-13.92	-13.29	183.6	188.2	4507	4524	3784	3770	-11.6	-8.5
November	-13.44	-12.65	183.1	189.0	4533	4550	3799	3776	-14.3	-10.2
December	-13.03	-12.83	183.7	189.5	4560	4578	3813	3787	-17.0	-12.6
January 1988	-14.43	-12.74	184.4	188.2	4581	4607	3814	3792	-16.3	-14.5
February	-14.02	-12.06	184.9	188.4	4600	4626	3811	3795	-15.8	-16.1
March	-13.90	-11.79	184.3	188.3	4619	4651	3808	3797	-15.4	-15.6

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	250.8	250.8	701.2	701.4	2765.2	2760.7	5.85	5.85	5.26	5.26
November	252.9	252.8	713.5	712.4	2781.4	2775.4	6.04	6.04	5.41	5.41
December	254.9	255.3	730.4	730.5	2804.3	2799.8	6.91	6.91	5.55	5.55
January 1987	257.3	258.8	735.3	737.6	2826.5	2822.0	6.15	6.43	5.47	5.44
February	259.2	259.3	738.4	737.2	2841.6	2821.3	6.22	6.10	5.43	5.59
March	261.1	260.6*	744.5	740.6*	2856.8	2829.9*	6.02	6.15*	5.45	5.66*
April	262.5	261.3	750.6	744.3	2873.4	2844.0	5.64	6.13	5.33	5.73
May	264.0	263.0	755.3	749.0	2895.5	2862.0	5.53	6.20	5.25	5.78
June	265.6	263.9	759.9	752.1	2917.3	2876.3	5.51	6.26	5.18	5.84
July	267.4	265.0	765.3	755.8	2932.4	2893.3	5.27	6.34	5.03	5.87
August	269.1	266.4	771.0	759.5	2945.6	2913.3	5.34	6.25	5.09	5.74
September	270.8	267.9	776.8	763.0	2958.1	2929.7	5.53	6.29	5.15	5.78
October	272.2	269.2	780.1	767.2	2976.4	2945.8	5.82	6.23	5.37	5.73
November	273.9	270.5	783.4	771.5	2997.9	2966.4	5.93	6.38	5.42	5.80
December	275.5	272.3	786.8	776.6	3018.8	2986.0	6.03	6.50	5.48	6.02
January 1988	276.9	274.0	791.2	780.9	3034.6	3002.5	6.15	6.53	5.53	6.06
February	278.9	275.7	795.1	787.1	3049.1	3020.5	6.19	6.47	5.60	6.01
March	280.8	277.6	799.0	791.7	3064.0	3041.6	6.18	6.55	5.56	6.07

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	8.86	8.86	7.08	7.08	5.68	5.68	5.69	5.69	7.50	7.50
November	8.68	8.68	6.85	6.85	5.76	5.76	5.76	5.76	7.50	7.50
December	8.49	8.49	6.86	6.86	6.10	6.10	6.04	6.04	7.50	7.50
January 1987	8.46	8.36	6.53	6.61	6.10	5.84	6.05	5.87	7.50	7.50
February	8.55	8.38	6.67	6.61	6.13	6.05	6.15	6.10	7.50	7.50
March	8.51	8.48*	6.62	6.83*	6.00	6.20*	6.07	6.22*	7.50	7.50*
April	8.43	8.51	6.53	6.88	5.56	6.16	5.63	6.23	7.50	7.75
May	8.41	8.64	6.50	7.00	5.43	6.19	5.52	6.28	7.50	7.75
June	8.29	8.77	6.43	7.13	5.28	6.31	5.35	6.42	7.29	7.86
July	8.25	8.82	6.37	7.20	5.20	6.37	5.29	6.48	7.00	8.00
August	8.37	8.86	6.49	7.26	5.29	6.20	5.34	6.33	7.00	8.00
September	8.49	8.75	6.61	7.15	5.52	6.33	5.63	6.40	7.48	8.00
October	8.75	8.71	6.84	7.10	5.78	6.30	5.89	6.41	7.50	8.00
November	8.85	8.93	6.93	7.32	5.93	6.46	5.98	6.57	7.61	8.00
December	8.92	9.07	7.00	7.46	6.05	6.58	6.19	6.67	7.75	8.18
January 1988	9.03	9.15	7.12	7.56	6.17	6.55	6.31	6.71	7.75	8.25
February	8.90	9.11	6.99	7.50	6.22	6.50	6.37	6.65	7.75	8.25
March	8.92	9.20	7.01	7.56	6.20	6.57	6.33	6.69	7.75	8.25

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

5/11/87 U1880-3

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MONTHLY PROJECTIONS April 1987

Dr. Donald Ratajczak, Director
For Release: April 30, 1987

INFLATIONARY WORRIES NOW EXCEEDING INFLATIONARY REALTY

A month ago, it appeared that investors were trying to overlook the inflationary fallout that was being generated by a devaluing dollar. Although GSU has been gradually raising its inflation forecast for the year because of these inflationary implications, there appeared to be little response from fixed income investors. As a result, it appeared that only a gradual awakening to the gradually intensifying inflationary environment would materialize. For that reason, we assumed that interest rates would drift upward, although our earlier forecast that economic weakness could cause interest rates to decline in the spring had been rejected in our previous projections.

In the past few weeks, however, fixed income investors have caught an inflation chill and have caused long-term interest rates to move dramatically higher. For example, the long-term government bond has increased in yield from 7.4% to 8.8% before rallying slightly in recent days. Corporate bonds have not shown a similar change, but yields have moved above 9% from 8.3% only three weeks ago. The greatest damage has occurred in the municipals market, where heavy supplies already were increasing spreads when the weakness in bond prices in other markets became apparent. As a result, municipal yields increased to more than 8% on the bond buyer at its worst point before rallying slightly in the last few days. Indeed, changes in market sentiment were so abrupt that historical spreads between mortgage-backed securities and ten-year treasury issues became unusually wide while the bond buyer traded in excess of 0.9 times the corporate AAA.

This rapid surge in interest rates could be the result of several prospects. Either investors are now awakening to the increased inflationary pressures generated by a declining dollar or they are observing a faster deterioration in the prospects for price stability than appeared likely only a month ago. In fact, a little of both explanations appear to be appropriate. However, increased inflationary prospects are being generated by the dollar's further decline against foreign currencies. Most of this dollar decline has resided in the yen-dollar relationship. In recent days, European currencies also appreciated against the dollar, but the trade-weighted index only deteriorated from 100 to 96 during April. The inflationary fallout from such a

moderate deterioration in the dollar's value is not insignificant, but it should add only 0.2 percentage points to our inflation projections for 1987.

Of course, the markets may be concerned with the effects that this heightened inflationary outlook will have upon inflationary psychology and wage demands in 1988. Already, inflationary psychology appears to be causing higher price adjustments in the service economy than are warranted by cost pressures. If wages begin responding to these heightened inflationary concerns, cost pressures could cause total wage costs to grow by 5% in 1988. (Remember, social security taxes will rise sharply during January of that year). Thus, the beginning of an inflationary spiral could develop if the dollar depreciates further.

On the other hand, the dollar's decline probably is nearing an end. Although the dollar could fall to 125 yen before wage cost equality is established between Japanese export industries and manufacturing in the United States, wage costs in Japan currently are higher per hour worked in all manufacturing than they are in the United States. Similarly, wage costs are significantly higher in Europe per hour worked than they are in the U.S. Currency changes already have established levels that should prevail in long-term equilibrium conditions. Certainly, the dollar is close enough to an equilibrium value even against Japan's export-oriented industries to become stable if interest rate differentials are widened slightly further. Thus, further substantial dollar deterioration should not be anticipated. However, enough inflationary damage has been generated to force the Federal Reserve to create those interest rate differentials that will guarantee stability between the dollar and other currencies.

Probably of greater significance than the increasing inflationary fallout from a falling dollar is the growing awareness that inflation is indeed intensifying. In fact, while interest rates undoubtedly increased much more dramatically much earlier than anticipated, current yields are not significantly above values projected for early 1988. Thus, the markets appear to have awoken to inflationary concerns and have now fully adjusted for reasonable inflationary fears through next year. If that is the case, little further increases in long-term interest rates should be anticipated, even as the Federal Reserve increases short-term rates in order to insure more stable exchange rates.

Of course, if the economy were weakening dramatically, such rising inflationary fears would soon dissipate. However, the GNP during the first quarter expanded a healthy 4.3%. Some commentators have indicated that, as final sales fell 2.2%, all of this activity was borrowing from the second quarter. However, a significant amount of the plunge in final sales was the result of reduced purchases by the Commodity Credit Corporation in the first quarter. From inventories that were purchased by the government and stored during the fourth quarter, causing an increase in government spending and a decrease in farm inventories, were stored by private farmers in the first quarter. Excluding the Commodity Credit Corporation fluctuations, final sales would have increased 0.4% in the first quarter.

Also, some final sales were shifted into the fourth quarter at the expense of the first quarter. About 250,000 automobiles were sold in December in order to beat the repeal of sales tax deductibility. This robbed auto sales from the first quarter but should have no notable effect upon auto sales in the spring. Also, changes in depreciation schedules encouraged many purchasing agents to

accelerate the receipt of capital goods in the fourth quarter. This explains the surge in durable shipments and orders in November and December followed by a plunge in January. This probably shifted \$9 billion of investment activity into the fourth quarter at the expense of first quarter activity. These shifts alone will add \$15 billion of real final sales to second quarter economic activity.

Although the trade balances probably will not be improving as sharply in the second quarter as in the first quarter, because more oil will be imported, some improvement in trade balances should be expected. Adding several billion dollars for government and another \$10 billion for non-auto consumer spending but taking away a few billion dollars from housing activity should lead to gains in final sales in excess of \$32 billion.

The level of economic activity in the second quarter will be determined by the degree of inventory accumulation. Automobile inventories are excessive and will be reduced in the spring. However, increasing commodity inflation probably will encourage increased inventory holdings both by wholesalers and manufacturers. Although some reduction in inventory investment is anticipated, the degree of reduction should not be sufficient to stall economic activity.

Inflation as measured by the GNP deflator was lower than our anticipations as import prices continued to expand rapidly. Because of the absence of import pricing in inventory adjustments, inventories that arrive from abroad are overstated in volume. Only when those inventories are used for final purposes will the appropriate price adjustments be reflected. Thus, when import prices are rising sharply, as they have been during the fourth quarter and the first quarter this year, the GNP deflator understates underlying inflation. When the dollar stabilizes, which may occur toward the end of this year, the GNP deflator will tend to overstate underlying inflation. At the present time, a better measure of inflationary pressures is the CPI and PPI indices. Both of these indices are showing significant acceleration. However, one portion of this acceleration has been caused by energy prices. Energy price gains now are beginning to slow. Indeed, we anticipate only slightly more than \$18 per barrel of oil in 1987 and an increase to slightly less than \$20 per barrel in 1988. This will result in lower rates of inflation for the energy components during the remainder of this year and next year than has been experienced over the past six months.

Quarterly Profile of GNP

	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1988</u> <u>Annual</u>	<u>1987</u> <u>Annual</u>
Real:	4.3	1.8	2.4	1.8	2.0	2.5	2.7
Price:	3.5	4.1	4.6	4.7	4.5	3.1	4.3
Nominal:	7.8	6.1	7.1	6.6	6.5	5.7	7.1

Monthly Statistical Highlights for April 1987

Payroll employment +180,000; index of hours worked +0.2%; household employment +216,000; civilian unemployment rate 6.6%; personal income +0.4%; savings rate 3.6%; personal consumption +0.3%; retail sales -0.1%; auto sales

9.7 million units; housing starts -1.2%; housing permits -2.5%; construction expenditures -0.6%; business inventories +0.4%; orders for durable goods -2.3%; orders for nondefense capital goods -2.5%; industrial production UNC; CPI +0.3%; PPI +0.5%; consumption deflator +0.4%; leading indicators +0.4%; real GNP +0.6%; M1 +15.8%; M2 +8.7%.

Monthly Statistical Highlights for May 1987

Payroll employment +108,000; index of hours worked +0.1%; household employment +153,000; civilian unemployment rate 6.6%; personal income +0.4%; savings rate 3.6%; personal consumption +0.3%; retail sales -0.2%; auto sales 9.5 million units; housing starts -2.6%; housing permits -3.5%; construction expenditures -0.5%; business inventories +0.6%; orders for durable goods -0.5%; orders for nondefense capital goods -0.3%; industrial production +0.2%; CPI +0.5%; PPI +0.2%; consumption deflator +0.4%; leading indicator -0.3%; real GNP 2.9%; M1 +3.8%; M2 6.2%.

COMMENTARY

Employment - Initial unemployment claims continue to decline, averaging only 330,000 during the early weeks of April. More importantly, the insured unemployment rate has dipped to 2.5%. Normally, this dip would be consistent with a modest dip in the unemployment rate. However, the significant reduction in hours during March strongly suggests that less than normal expansion in payrolls should be anticipated. For that reason, no adjustments have been made to our payroll estimates.

Personal Income and Outlays - March wages and salaries increased more than anticipated, although manufacturing payrolls declined. Given a significant reduction in hours, smaller gains in wage and salaries were anticipated. Also, property income is beginning to rise as interest income begins to increase. More substantial gains are anticipated for interest income in the months ahead. Therefore, personal income is expected to grow more rapidly than wages and salaries for the remainder of this year.

Savings rates are expected to slow significantly during the second half of the year as a result of the change in tax liabilities. Because of the bracketing for inflation, tax liabilities are significantly reduced early in the year and then gradually increase as the year progresses. This causes higher savings early in the year followed by reduced savings later on. Apparently, consumers are aware of this shift in liabilities through the year and are not altering their consumption patterns to reflect the savings shifts caused by intra-year tax liability changes. Thus, gains from the W-4 under-withholding problem really should not be substantial in stimulating consumer spending in 1987 or in retarding it during 1988.

Automobile sales are not responding as aggressively to the latest incentives as in the past. The result will be reduced auto sales through the spring. This, in turn, should reduce retail activity and slow the growth of consumer spending. However, a significant upward revision in sales of non-auto durables, especially furniture and home improvement items, will lead to more substantial gains for durable spending through much of this year. When housing activity slows later in the year, however, little further growth is expected for non-auto

durables. The more dramatic increases in nondurables than contained in our February forecast is the result of higher oil prices in the spring than originally anticipated. Because of the Saudi Arabian resolve to remain the swing producer for oil, there will be no backsliding in petroleum product prices this year. Our forecast assumed some moderate backsliding followed by firming as the heating season approached toward the end of the year.

Construction - As more normal weather patterns developed in the spring, housing starts slowed. However, single-family starts remain relatively robust. Moreover, they remain stronger than is justified by current sales activity. Single-family sales slowed to 699,000, nearly 70,000 below peak sales levels during 1986. As a result, a significant slowing in single-family starts would have been expected even before mortgage rates moved above 10% in April. With higher mortgage rates, housing activity will slow more substantially later in the year than originally projected.

The return of more normal weather also should be apparent in construction expenditures, which are expected to decline significantly in the next few months. Prices of construction materials remain modest although a 15% adjustment in Canadian lumber exports and increasing American exports of hardwoods, especially red oak, are placing some modest upward pressures upon the construction deflator. At the present time, however, wage pressures are not apparent.

Business Activity - Defense activity was surprisingly strong in March as defense shipments and orders rebounded sharply. Nondefense activity also was strong, although aircraft was a significant contributor to both sectors. A slight increase in automobile activity also was appropriately reflected. A significant pullback in defense activity and a reduction in aircraft shipments should occur next month. However, shipments certainly are stronger during the second quarter than early in the year, when fixed investment fell sharply from the fourth quarter.

Inventory increases in February were heavily concentrated in automobiles and nondurable goods. The increase in nondurable goods at wholesale may reflect price considerations. The inventory figures have been adjusted for a new accounting of the LIFO provision. The net result has been a significant expansion in the dollar value of inventories. However, this adjustment is an accounting change and does not appear to significantly alter the degree of inventory imbalance relative to economic activity.

Industrial production fell as anticipated in March, but automobiles still were assembled at a 7.9 million clip. Further reductions in auto assemblies are expected in April in order to bring inventories into line with reduced sales. However, an increase in industrial materials and in business equipment should offset continued weakness in consumer goods.

Prices - Auto rebates remained in place through April. As a result, relatively modest inflationary pressures are expected in April. However, when the rebates are removed in May a significant surge in the price indices should develop. In addition, accelerating commodity prices are beginning to be reflected in the industrial commodities index. The increasing discrepancy between the CPI and the PPI appears to be the result of import prices. The PPI is a domestic index and does not directly incorporate the influence of import prices while the CPI captures prices of all goods purchased by consumers.

Miscellaneous - The leading indicators rose as a result of strong gains for stock market prices and plant and equipment orders. Gains also were significant for vendors performance and initial unemployment claims. Most of these gains will not persist in April. However, sufficient increases are anticipated for the money stock and sensitive prices to ensure another modest increase in the leading indicators at that time. Little further gain is expected in the leading indicators for the remainder of this year. Further gains in the leading indicators will need to come from orders, stock market changes, and the money stock. However, an acceleration in inflationary pressures probably will prevent the real money stock from growing significantly. If the stock market is about to peak, as some indicators suggest, there will be little further forward thrust for the leading indicators.

The trade balances have been revised to reduce the inappropriate reporting that has plagued the data in past months. Thus, the surge in trade deficits during February could be more a statistical than real aberration. According to the GNP components, however, some deterioration in the trade balances appears to have developed in February and only a modest improvement from those levels seems likely in March. As the dollar declined significantly during March and early April, goods arriving in this country in May and June probably will be experiencing higher dollar costs. A significant increase in oil imports is expected in April. Therefore, improvement in the trade balances is not likely until the end of the year, after the dollar has stabilized.

Financial Markets

Inflationary fears and the absence of foreign purchases appears to have done the most damage to the fixed income markets during April. Economic activity was not especially vigorous. However, loan activity did not diminish significantly after the April 15 tax date. At least in the short end of the market, credit market pressures were intensifying. It does not appear that inventory accumulations were the primary reason for increased borrowings. A slight movement towards liquidity may be the reason for the upward pressures on short-term rates.

Corporate borrowings are intensifying during the second quarter as fixed investment rebounds from its winter lull and inventory accumulations remain relatively high. Some of this increased borrowing is being met by improved corporate earnings. However, higher commodity inflation is increasing the borrowing needed to support current inventory holdings.

The household sector probably will diminish their savings during the second quarter as automobiles begin rebounding following the first quarter dip. Mortgage activity may spurt slightly as rising mortgage rates cause some previous fence sitters to rush into the market before interest rates rise further. Thus, net contributions to the credit markets from the household sector could diminish slightly.

Despite the adverse shift in corporate and consumer needs, the credit markets are being influenced by perceptions of foreign sentiment. Dollar weakness has raised the spectre that Japanese investors will not be taking their normal more than one-third of the ten- and thirty-year government bonds when they are auctioned next week. In fact, the rising interest rate differential

between Japan and the United States should insure a significant presence by Japanese investors.

Of course, the Federal Reserve must institutionalize the higher short-term interest rates that the markets currently are dictating by increasing the discount rate. It would be appropriate for such a discount move to occur prior to the auction to insure significant contributions from foreign investors. Further upward pressures on short-term interest rates are expected later in the year, when the dollar could show further weakness. However, improving trade balances late in the year probably will prevent much further dollar weakness early in 1988. At that time, interest rates are expected to stabilize.

Equity Markets - The equity markets are being buffeted by higher interest rates on the one hand and increased earning opportunities on the other as export markets gradually improve and domestic producers and consumers substitute American product for foreign goods. However, the stock market does not appear to have yet recognized the magnitude of interest rate increase in the long-term bond market. As short-term interest rates rise, financial costs will be rising. This will lead to a change in the composition of capital earnings, with a greater percentage of that composition falling to interest recipients rather than to equity owners. For that reason, the stock market probably has already reached its high for the year. Nevertheless, a rebound to that high is possible in the next few weeks once bond markets stabilize. The Dow Jones average probably will end the year just above 2000, indicating that a significant but not dramatic selloff is likely between now and year-end.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	100826	100826	118.6	118.6	110192	110192	6.9	6.9	170.0	170.0
November	101065	101068	119.3	119.3	110432	110432	6.9	6.9	170.9	170.8
December	101334	101322	119.0	119.0	110637	110637	6.7	6.7	170.8	170.6
January 1987	101542	101626	119.5	119.9	110857	111011	6.7	6.7	171.2	170.7
February	101770	101862	119.8	120.9	111092	111382	6.7	6.7	171.6	171.4
March	102010	102026	120.2	120.4	111582	111368	6.6	6.6	172.0	171.8
April	102197	102206*	120.4	120.6*	111723	111584*	6.6	6.6*	172.3	172.2*
May	102378	102314	120.6	120.7	111892	111727	6.6	6.6	172.6	172.5
June	102583	102492	120.8	120.9	111794	111913	6.6	6.6	172.8	172.9
July	102769	102586	121.0	121.0	112093	112039	6.6	6.7	173.2	173.2
August	102979	102773	121.3	121.2	112406	112231	6.7	6.7	173.7	173.6
September	103188	102942	121.5	121.4	112725	112439	6.6	6.6	174.1	174.1
October	103356	103121	121.7	121.6	112846	112634	6.5	6.6	174.5	174.5
November	103532	103299	121.9	121.8	113009	112841	6.5	6.6	174.8	175.0
December	103690	103478	122.1	122.0	113205	113044	6.4	6.6	175.1	175.4
January 1988	103857	103580	122.3	122.1	113398	113191	6.4	6.7	175.9	175.9
February	104060	103758	122.5	122.3	113587	113382	6.4	6.7	176.7	176.6
March	104188	103861	122.6	122.4	113773	113512	6.4	6.7	177.4	177.2

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	3.519	3.518	2.102	2.102	102.8	93.4	2.991	2.989	2.888	2.896
November	3.527	3.523	2.112	2.112	88.2	92.7	2.994	2.990	2.905	2.897
December	3.555	3.543	2.119	2.115	55.7	36.6	3.019	3.000	2.963	2.963
January 1987	3.560	3.553	2.133	2.129	139.3	118.8	3.059	3.024	2.920	2.905
February	3.574	3.599	2.145	2.145	119.4	103.2	3.067	3.075	2.948	2.972
March	3.588	3.604	2.157	2.153	106.7	105.6	3.075	3.087	2.968	2.981
April	3.602	3.618*	2.165	2.164*	108.5	111.7*	3.092	3.102*	2.984	2.990*
May	3.617	3.632	2.173	2.171	108.3	111.3	3.104	3.112	2.996	3.001
June	3.633	3.649	2.180	2.182	111.3	103.4	3.117	3.124	3.006	3.021
July	3.647	3.663	2.191	2.189	103.9	97.8	3.125	3.134	3.021	3.036
August	3.661	3.680	2.203	2.200	91.6	89.0	3.133	3.146	3.041	3.057
September	3.675	3.698	2.215	2.211	79.7	81.7	3.141	3.159	3.061	3.077
October	3.695	3.716	2.222	2.222	84.4	93.2	3.156	3.171	3.072	3.078
November	3.704	3.733	2.231	2.233	75.1	84.0	3.161	3.183	3.086	3.099
December	3.734	3.751	2.240	2.244	87.7	83.9	3.186	3.197	3.098	3.113
January 1988	3.739	3.763	2.254	2.253	104.0	112.7	3.219	3.238	3.115	3.125
February	3.760	3.786	2.262	2.268	106.6	125.5	3.236	3.264	3.129	3.139
March	3.783	3.804	2.270	2.279	110.4	130.2	3.255	3.282	3.145	3.152

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	2789.4	2797.4	391.3	396.8	934.3	934.6	1463.8	1466.0	2423.8	2430.2
November	2806.5	2798.8	386.9	381.2	939.4	938.0	1480.3	1479.5	2432.7	2427.6
December	2863.8	2865.2	434.4	431.4	946.4	947.6	1483.0	1486.1	2478.8	2479.6
January 1987	2820.0	2806.6	375.6	364.8	950.3	946.8	1494.1	1495.0	2428.9	2408.9
February	2846.8	2873.7	386.5	394.3	955.8	970.0	1504.5	1509.3	2439.4	2460.0
March	2866.7	2882.6	390.5	397.2	961.2	971.6	1515.0	1513.9	2443.9	2459.3*
April	2881.2	2891.4*	392.7	393.3*	964.8	975.7*	1523.7	1522.4*	2452.1	2457.5
May	2892.8	2901.5	394.9	389.1	965.9	979.5	1532.0	1532.9	2455.7	2455.8
June	2902.2	2921.1	395.6	395.5	966.3	983.9	1540.3	1541.7	2457.4	2464.0
July	2916.8	2936.3	395.1	398.7	970.6	986.8	1551.1	1550.8	2463.5	2469.1
August	2936.3	2956.8	400.3	406.2	974.7	990.2	1561.3	1560.4	2471.6	2478.1
September	2955.4	2976.7	404.6	414.8	978.8	992.4	1572.0	1569.5	2479.4	2485.1
October	2964.9	2976.8	401.5	401.3	983.0	996.4	1580.4	1579.1	2479.0	2475.6
November	2978.6	2997.5	403.8	407.2	986.7	999.6	1588.1	1590.7	2480.1	2484.3
December	2990.3	3011.2	404.0	408.2	990.5	1003.4	1595.8	1599.6	2477.5	2485.6
January 1988	3006.2	3022.9	405.6	409.1	994.3	1005.4	1606.3	1608.4	2482.4	2487.4
February	3019.8	3035.6	404.9	410.2	997.1	1008.8	1617.8	1616.6	2485.4	2489.5
March	3034.4	3048.3	405.1	410.5	1000.0	1012.3	1629.3	1625.5	2487.2	2490.5

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	121.66	121.66	19.25	19.25	10.3	10.3	73.98	73.98	28.44	28.44
November	120.94	121.06	19.25	19.27	10.5	10.5	74.23	74.04	27.46	27.75
December	126.26	126.94	19.53	19.67	13.6	13.6	74.81	74.75	31.92	32.52
January 1987	120.53	118.58	19.46	20.04	8.8	8.2	75.23	74.81	25.84	23.73
February	121.13	124.41	19.32	20.76	9.3	9.9	75.56	76.73	26.25	26.93
March	122.60	124.67	19.30	20.65	9.7	10.2	75.92	76.82	27.38	27.20
April	122.86	124.53*	19.35	20.83*	9.9	9.7*	76.21	77.14*	27.30	26.56*
May	123.39	124.32	19.40	20.87	10.1	9.5	76.35	77.44	27.64	26.01
June	123.88	125.44	19.47	21.00	10.2	9.8	76.49	77.79	27.92	26.65
July	124.33	126.06	19.50	21.03	10.1	10.0	76.73	78.02	28.10	27.01
August	125.02	127.23	19.56	21.02	10.2	10.4	77.08	78.29	28.38	27.92
September	125.32	128.44	19.53	21.10	10.2	11.0	77.42	78.46	28.37	28.88
October	125.98	127.03	19.58	21.19	10.2	9.6	77.72	78.78	28.68	27.16
November	126.54	128.09	19.55	21.23	10.3	10.0	78.03	79.03	28.96	27.83
December	126.80	128.51	19.50	21.19	10.3	10.1	78.35	79.33	28.95	27.99
January 1988	127.09	128.78	19.57	21.23	10.3	10.1	78.52	79.49	29.00	28.06
February	127.22	129.18	19.64	21.18	10.2	10.2	78.86	79.76	28.72	28.24
March	127.75	129.49	19.71	21.17	10.2	10.2	79.20	80.03	28.84	28.29

Fore. = February Forecast

C.E. = Current Expectations

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CONSTRUCTION

	Housing Starts		Single-family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	1.628	1.657	1.085	1.114	1.565	1.565	379.7	388.5	338.1	348.6
November	1.585	1.637	1.087	1.129	1.613	1.613	377.0	383.1	335.3	345.5
December	1.802	1.813	1.209	1.223	1.893	1.910	380.3	378.5	338.0	341.7
January 1987	1.613	1.816	1.088	1.253	1.496	1.690	380.7	374.8	337.8	339.0
February	1.597	1.833	1.075	1.299	1.523	1.763	375.4	378.4	332.2	341.3
March	1.610	1.774	1.091	1.245	1.516	1.757	374.7	375.2*	331.0	337.7*
April	1.633	1.753*	1.103	1.217*	1.534	1.713*	375.6	372.9	331.2	334.7
May	1.641	1.707	1.110	1.169	1.556	1.653	376.4	371.2	331.6	333.2
June	1.641	1.676	1.111	1.153	1.550	1.594	377.7	369.2	332.8	330.5
July	1.631	1.680	1.122	1.166	1.542	1.586	376.8	367.0	331.4	328.3
August	1.620	1.648	1.115	1.142	1.533	1.552	377.3	367.5	331.0	328.1
September	1.621	1.637	1.120	1.126	1.519	1.523	376.8	367.2	329.7	327.6
October	1.626	1.609	1.126	1.107	1.533	1.525	376.0	366.7	328.7	326.2
November	1.609	1.595	1.113	1.093	1.516	1.486	375.9	365.2	327.7	324.3
December	1.621	1.561	1.129	1.078	1.518	1.462	376.5	364.9	327.7	323.8
January 1988	1.621	1.560	1.116	1.084	1.524	1.469	376.8	364.4	327.4	322.8
February	1.636	1.554	1.125	1.073	1.518	1.473	376.7	364.1	326.7	322.2
March	1.623	1.564	1.120	1.080	1.522	1.478	378.4	364.5	327.3	322.0

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	129.1	133.4	71.9	73.2	178.6	181.9
November	128.2	129.4	70.7	71.5	178.0	182.2
December	128.5	126.9	72.2	73.0	179.6	178.6
January 1987	128.6	118.2	72.5	75.1	179.6	181.5
February	127.8	121.0	71.8	78.0	175.8	179.4
March	127.0	118.1*	71.0	75.1*	176.7	182.0*
April	126.8	115.6	72.3	75.8	176.5	181.5
May	126.5	115.3	73.7	75.0	176.2	180.9
June	126.4	115.0	75.1	75.3	176.2	178.9
July	126.6	113.9	74.6	75.7	175.6	177.4
August	126.8	114.3	75.1	76.3	175.4	176.9
September	126.8	114.5	74.9	76.6	175.1	176.1
October	127.5	113.8	73.9	77.1	174.6	175.8
November	128.2	113.6	73.6	77.5	174.1	174.1
December	129.0	114.2	73.8	77.8	173.7	172.9
January 1988	128.0	114.6	74.3	78.2	174.5	171.6
February	126.5	114.5	74.9	78.5	175.3	171.1
March	126.8	114.8	75.6	78.8	176.0	170.9

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BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	276.0	318.2	103.57	97.68	26.91	26.56	27.72	27.86
November	276.6	318.7	109.27	103.52	28.65	28.03	27.91	27.55
December	275.3	318.2	106.94	105.96	27.74	29.31	28.23	28.73
January 1987	277.8	320.7	103.46	95.47	26.43	26.76	27.06	25.83
February	279.5	320.4	105.92	101.94	27.17	26.90	27.11	26.84
March	279.3	320.3*	106.42	105.37	27.61	27.53	27.56	27.71
April	280.9	321.0	107.72	102.96*	28.13	26.84*	27.94	27.03*
May	282.0	321.6	107.93	102.43	28.52	26.75	28.06	26.62
June	283.0	322.5	106.85	104.16	28.35	27.13	28.04	27.05
July	284.2	323.2	106.14	104.79	28.05	27.52	28.17	27.46
August	285.5	324.0	106.26	106.24	28.19	28.07	28.26	28.13
September	286.5	324.9	106.52	108.63	28.32	28.84	28.35	29.12
October	288.1	326.0	107.83	102.97	28.86	26.95	28.57	27.16
November	289.8	327.3	108.84	104.42	29.03	27.15	28.75	27.20
December	291.1	328.9	110.23	104.93	29.62	27.46	28.93	27.67
January 1988	292.7	330.1	106.92	106.05	27.46	27.93	28.56	27.88
February	294.0	332.4	108.25	106.17	28.05	27.86	28.82	27.96
March	295.0	333.3	108.59	105.95	28.46	27.74	29.00	28.15

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	591.6	656.6	8.01	8.15	125.3	125.3	79.0	79.0
November	590.6	656.2	8.69	8.93	126.0	126.0	79.4	79.4
December	590.5	652.7	8.43	10.66	126.6	126.7	79.6	79.6
January 1987	593.7	659.0	8.46	8.27	126.9	126.5	79.7	79.4
February	597.5	660.2	8.59	8.40	127.1	127.1	79.9	79.7
March	597.9	662.8*	8.73	9.87	127.4	126.7	79.9	79.2
April	599.4	665.2	8.56	8.93*	127.6	126.7*	79.9	79.0*
May	602.2	669.0	8.82	8.95	127.8	126.9	79.9	79.0
June	604.8	672.1	8.87	9.13	128.1	127.2	80.0	79.1
July	607.3	673.8	8.83	8.76	128.1	127.3	79.8	78.9
August	609.5	675.0	8.76	8.92	128.2	127.5	79.7	78.9
September	611.4	675.2	9.36	9.15	128.7	127.7	79.9	78.9
October	614.2	679.8	8.92	8.84	129.2	128.0	80.2	79.0
November	618.3	681.3	8.95	8.93	129.6	128.2	80.3	79.0
December	621.0	684.0	9.00	9.00	129.8	128.4	80.3	79.0
January 1988	624.6	686.8	9.12	9.05	130.0	128.3	80.3	78.9
February	626.9	689.2	9.16	9.02	130.0	128.6	80.1	79.0
March	628.6	693.0	9.21	9.07	130.1	128.6	80.0	78.8

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PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	329.8	330.0	290.3	290.1	309.3	309.3	115.0	115.0
November	330.7	330.8	290.9	290.2	309.6	309.6	115.3	115.2
December	331.5	331.4	290.9	289.9	309.3	309.3	115.6	115.4
January 1987	333.0	333.6	291.8	291.7	312.3	313.6	116.1	116.0
February	334.7	335.0	294.0	291.9	314.7	315.7	116.6	116.2
March	335.5	336.3	295.1	293.1	316.5	315.8	117.1	116.5
April	336.2	337.3*	295.6	294.7*	314.7	315.8*	117.4	116.9*
May	337.0	338.9	296.2	295.3	312.8	316.9	117.6	117.4
June	338.7	340.1	296.8	296.1	312.4	317.5	117.6	117.8
July	339.5	341.2	297.5	296.8	313.0	318.2	118.0	118.2
August	340.1	342.4	298.2	297.6	314.3	319.0	118.5	118.7
September	340.7	343.7	298.9	298.4	312.9	316.3	118.9	119.2
October	341.9	344.9	300.0	298.8	315.7	320.4	119.1	119.6
November	343.4	346.4	301.0	299.6	316.1	321.1	119.3	120.1
December	345.0	347.6	302.1	300.4	316.5	321.8	119.6	120.5
January 1988	346.0	349.1	303.1	301.4	318.3	323.0	120.1	121.0
February	347.0	350.5	304.2	302.3	320.2	324.6	120.7	121.4
March	348.1	352.1	305.4	303.5	322.0	326.3	121.3	121.8

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	115.1	115.1	105.4	105.6	107.1	107.1	124.0	124.0	112.3	111.4
November	115.4	115.3	105.7	105.3	107.3	107.3	124.3	124.2	112.4	110.9
December	115.5	115.6	106.5	106.9	107.5	107.9	124.5	124.1	112.5	110.8
January 1987	116.1	116.5	106.0	106.0	108.3	109.2	125.0	124.8	112.7	110.6
February	116.7	116.8	106.2	106.4	109.1	109.8	125.5	125.2	113.0	110.9
March	117.3	117.2*	106.5	106.2*	109.6	110.3*	126.1	125.7*	113.2	111.1*
April	117.5	117.7	106.7	106.4	109.8	110.8	126.6	126.1	113.4	111.2
May	117.8	118.2	106.9	107.1	109.8	111.1	126.9	126.6	113.5	111.4
June	118.1	118.6	107.2	107.3	109.9	111.5	127.3	127.1	113.5	111.7
July	118.4	118.9	107.4	107.5	110.1	111.9	127.9	127.5	113.7	111.8
August	118.8	119.3	107.6	107.7	110.4	112.4	128.4	127.9	114.0	112.0
September	119.2	119.8	107.8	108.3	110.7	112.8	128.8	128.4	114.3	112.1
October	119.6	120.2	108.0	108.3	111.1	113.1	129.3	129.0	114.4	112.4
November	120.1	120.7	108.3	108.5	111.6	113.5	129.9	129.5	114.7	112.6
December	120.7	121.1	108.6	108.8	112.0	113.9	130.5	130.1	114.9	112.7
January 1988	121.1	121.5	108.8	109.0	112.4	114.3	131.1	130.5	115.1	112.9
February	121.5	121.9	109.0	109.2	112.7	114.7	131.6	131.0	115.3	113.0
March	122.0	122.4	109.3	109.5	113.1	115.1	132.1	131.5	115.6	113.2

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	-14.71	-12.06	180.4	180.9	4250	4246	3696	3692	-6.3	-6.3
November	-19.22	-19.22	182.5	182.5	4268	4260	3702	3698	-9.4	-9.0
December	-11.66	-10.66	184.1	186.8	4287	4270	3708	3700	-11.3	-9.3
January 1987	-15.25	-12.27	182.9	186.0	4309	4308	3711	3714	-16.3	-9.9
February	-14.37	-15.06	183.4	186.8	4347	4349	3728	3743	-20.5	-7.7
March	-13.79	-14.15p	183.0	187.5	4380	4361	3740	3743	-23.9	-7.6
April	-14.88	-15.16*	183.9	188.3*	4396	4378	3744	3745	-7.3	-9.2
May	-14.55	-14.43	184.3	187.8	4413	4407	3753	3754	-1.4	-7.1
June	-13.95	-14.71	184.8	187.7	4430	4427	3767	3758	-4.8	-5.6
July	-14.43	-14.46	185.1	188.0	4449	4444	3770	3760	-5.9	-6.4
August	-14.41	-14.43	184.7	187.7	4468	4471	3770	3767	-7.0	-7.6
September	-13.59	-14.86	184.2	188.3	4486	4494	3773	3770	-8.1	-8.5
October	-13.92	-14.72	183.6	187.7	4507	4523	3784	3781	-11.6	-8.9
November	-13.44	-14.20	183.1	187.5	4533	4531	3799	3773	-14.3	-9.6
December	-13.03	-13.89	183.7	187.9	4560	4571	3813	3793	-17.0	-10.8
January 1988	-14.43	-14.45	184.4	188.4	4581	4590	3814	3793	-16.3	-7.5
February	-14.02	-14.26	184.9	188.5	4600	4607	3811	3795	-15.8	-9.3
March	-13.90	-13.88	184.3	188.2	4619	4645	3808	3814	-15.4	-10.2

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	250.8	250.8	701.2	701.4	2765.2	2760.7	5.85	5.85	5.26	5.26
November	252.9	252.8	713.5	712.4	2781.4	2775.4	6.04	6.04	5.41	5.41
December	254.9	255.3	730.4	730.5	2804.3	2799.8	6.91	6.91	5.55	5.55
January 1987	257.3	258.8	735.3	737.6	2826.5	2822.0	6.15	6.43	5.47	5.44
February	259.2	259.3	738.4	737.2	2841.6	2821.5	6.22	6.10	5.43	5.59
March	261.1	260.5	744.5	739.2	2856.8	2825.6	6.02	6.13	5.45	5.60
April	262.5	261.7*	750.6	748.3*	2873.4	2845.4*	5.64	6.30*	5.33	6.07*
May	264.0	262.9	755.3	750.6	2895.5	2859.6	5.53	6.55	5.25	6.20
June	265.6	263.8	759.9	751.8	2917.3	2871.0	5.51	6.47	5.18	6.16
July	267.4	264.9	765.3	755.0	2932.4	2885.4	5.27	6.56	5.03	6.23
August	269.1	266.2	771.0	758.1	2945.6	2899.8	5.34	6.58	5.09	6.28
September	270.8	267.5	776.8	761.8	2958.1	2917.2	5.53	6.73	5.15	6.49
October	272.2	269.0	780.1	766.4	2976.4	2934.8	5.82	6.79	5.37	6.45
November	273.9	270.2	783.4	769.5	2997.9	2952.4	5.93	6.75	5.42	6.43
December	275.5	271.6	786.8	774.1	3018.8	2970.0	6.03	6.64	5.48	6.32
January 1988	276.9	273.1	791.2	778.3	3034.6	2987.8	6.15	6.51	5.53	6.26
February	278.9	274.5	795.1	782.6	3049.1	3004.3	6.19	6.58	5.60	6.35
March	280.8	276.2	799.0	787.4	3064.0	3022.7	6.18	6.69	5.56	6.41

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October	8.86	8.86	7.08	7.08	5.68	5.68	5.69	5.69	7.50	7.50
November	8.68	8.68	6.85	6.85	5.76	5.76	5.76	5.76	7.50	7.50
December	8.49	8.49	6.86	6.86	6.10	6.10	6.04	6.04	7.50	7.50
January 1987	8.46	8.36	6.53	6.61	6.10	5.84	6.05	5.87	7.50	7.50
February	8.55	8.38	6.67	6.61	6.13	6.05	6.15	6.10	7.50	7.50
March	8.51	8.36	6.62	6.66	6.00	6.16	6.07	6.17	7.50	7.50
April	8.43	8.84*	6.53	7.52*	5.56	6.40*	5.63	6.56*	7.50	7.73*
May	8.41	9.07	6.50	7.89	5.43	6.62	5.52	6.73	7.50	8.13
June	8.29	8.89	6.43	7.56	5.28	6.50	5.35	6.64	7.29	8.25
July	8.25	9.07	6.37	7.76	5.20	6.58	5.29	6.71	7.00	8.25
August	8.37	9.03	6.49	7.68	5.29	6.73	5.34	6.84	7.00	8.25
September	8.49	9.16	6.61	7.86	5.52	6.78	5.63	6.89	7.48	8.25
October	8.75	9.27	6.84	8.02	5.78	6.80	5.89	6.93	7.50	8.36
November	8.85	9.25	6.93	8.00	5.93	6.71	5.98	6.83	7.61	8.50
December	8.92	9.06	7.00	7.79	6.05	6.58	6.19	6.69	7.75	8.50
January 1988	9.03	8.93	7.12	7.64	6.17	6.42	6.31	6.56	7.75	8.50
February	8.90	8.98	6.99	7.68	6.22	6.49	6.37	6.62	7.75	8.50
March	8.92	9.06	7.01	7.75	6.20	6.57	6.33	6.71	7.75	8.50

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

6/8/87

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MONTHLY PROJECTIONS May 1987

Dr. Donald Ratajczak, Director
For Release: June 2, 1987

WHO IS RUNNING THE FEDERAL RESERVE?

During the middle of May inflationary jitters caused a dramatic increase in commodity prices. Although a large one-day increase in the CRB index was instigated by worries of impending drought in the midwest, the market response clearly was exaggerated by rising inflationary concerns. Indeed, the drought was dramatically overdone as flooding has now replaced dry soil as a chief concern in parts of the midwest. However, the inflationary surge in commodity prices, although it has since partially reversed, will be reflected in the May PPI, which was surveyed during the drought scare, and in the May CPI.

While these inflationary jitters intensified, the Federal Reserve did very little. Although M1 slowed in May following an unusually large surge in April, other monetary aggregates apparently grew near the upper end of the Federal Reserve target range. Both the monetary base and currency showed growth rates that would not be consistent with Federal Reserve monetary targets for the year. Moreover, the slowing in M1 apparently was the result of unusually large treasury deposits accumulating at the Federal Reserve. These deposits exhausted reserves from the banking system as unusually heavy payments for 1986 capital gains came flowing into treasury coffers. As the treasury draws down these balances, reserves will be released to the banking system and M1 will grow more rapidly in June. This increased liquidity may also restrain short-term interest rates during this month.

Of course, the Federal Reserve may have anticipated these shifts in available reserves and concluded that short-term interest rates were temporarily unusually high. They may also have thought that the dollar had fallen below fundamental values with respect to other currencies and was now undervalued. Indeed, the dollar is strengthening on foreign currency markets on the eve of the Venice economic summit. The belief by foreign investors that something will be accomplished at Venice has also begun to stabilize the long-term bond market.

However, anything from Venice must include changed macroeconomic policies in the leading industrial countries. Germany repeatedly announces that it will not alter the timing of its tax cut proposals nor will it pursue more expansionary monetary policy than currently is in place. Japan has announced a new stimulus package but they've also mentioned that this is the last stimulus package to be considered in this decade. Interest rates also have been reduced in Japan, although the speculative nature of the real estate and equity markets in that country suggests that changes in Japanese monetary policy without any restructuring of the Japanese economic system may be counterproductive. The United States has showed no increased willingness to reduce its government deficits. Even with unusually strong tax collections in April, the deficit for this fiscal year probably will miss the \$144 billion Gramm-Rudman target by nearly \$35 billion. A \$36 billion budget reduction from that level depends heavily upon \$18 billion of increased revenues, which are not likely to be endorsed by the President. Thus, only an increase in monetary restraint in the United States appears to be available to achieve any of the stability in foreign exchange that is currently being sought by foreign investors.

Yet, the Federal Reserve shows no tendency to engage in such monetary restraint. While short-term interest rates have increased, this appears to be the combined influence of the shift in treasury deposits and increased inflationary concerns. Commercial paper rates have been above the federal funds rate for the past two months while CD rates have widened appreciably relative to commercial paper rates. This suggests that lenders are demanding higher yields before they are willing to provide funds. Indeed, another 0.25 percentage increase in the prime rate currently is justified by the prevailing cost of funds. In short, conditions in the private economy rather than monetary policy are directly responsible for rising short-term interest rates at the present time.

In fact, the one interest rate directly under the Federal Reserve's control, the discount rate, remains unchanged. Why? The Federal Reserve had an opportunity to raise the discount rate prior to the quarterly funding in early May. An increase in the rate at that time probably would have encouraged foreign investors by suggesting that the Federal Reserve was willing to preserve higher short-term interest rates to defend the dollar. By failing to increase the discount rate, foreign investors hesitated buying government securities, leading to higher long-term interest rates than otherwise would have prevailed. The Federal Reserve again failed to respond to inflationary jitters in mid-May with a discount rate increase. An especially favorable time would have been during the Memorial Day Weekend. This would have occurred immediately after the open market committee meeting and would have signaled that the Federal Reserve had shifted toward restraint as a result of deliberations in that meeting.

Of course, the Federal Reserve may be waiting until Venice, either to indicate our resolve by raising the discount rate just prior to the meeting, or by using a discount rate increase to bargain for interest rate reductions in Germany and Japan. In the meantime, banks with seasonal borrowing needs are receiving unusually cheap money as they go to the discount window. Other short-term interest rates are partially being restrained by this bargain provided by the Federal Reserve. With commodity inflation heating up, this restraint upon short-term interest rates will encourage increased inventory accumulations. While such additional inventory holdings will create increased economic growth, it will also increase prospects for inventory imbalances, which could lead to a decline in economic activity following a surge in commodity inflation that will be sustained by inventory demand.

Although the Federal Reserve may be waiting for the "right" time to raise the discount rate, despite the presence of several "right" times during May, it may also be that the Federal Reserve has not decided that restraint is necessary. Given the mid-May inflationary jitters and the apparent resolve of Chairman Paul Volcker to fight an inflationary psychology, which has caused nearly a 1.5 percentage point gain in long-term interest rates, such an absence of policy resolve suggests that Paul Volcker did not control the Federal Reserve board.

The conclusion that Paul Volcker was not in full control of the board probably explains why he refused a third term as chairman. Why would he accept responsibility for a policy he no longer controls? In fact, the absence of monetary restraint following the Venice economic summit may well lead to adverse market responses. Once again, foreign investors appear to be holding hope for currency stability that cannot yet be achieved.

Quarterly Profile of GNP

	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1988-2</u>	<u>1987</u> <u>Annual</u>	<u>1988</u> <u>Annual</u>
Real:	4.4	1.0	2.9	2.0	0.7	2.2	2.4	1.6
Price:	4.2	4.4	4.2	4.5	5.0	5.0	3.3	4.8
Nominal:	8.7	5.5	7.1	6.5	5.8	7.0	5.6	6.8

Monthly Statistical Highlights for May 1987

Payroll employment +265,000; index of hours worked +0.3%; household employment +201,000; civilian unemployment rate 6.3%; personal income +0.6%; savings rate 3.5%; personal consumption +0.3%; retail sales -0.6%; auto sales 9.6 million units; housing starts -4.1%; housing permits -3.6%; construction expenditures -0.8%; business inventories +0.4%; orders for durable goods -2.2%; orders for nondefense capital goods -1.3%; industrial production +0.4%; CPI +0.6%; PPI +0.6%; consumption deflator +0.4%; leading indicator +0.5%; real GNP +1.3%; M1 5.4%; M2 6.1%.

Monthly Statistical Highlights for June 1987

Payroll employment +158,000; index of hours worked +0.1%; household employment +223,000; civilian unemployment rate 6.3%; personal income +0.5%; savings rate 3.5%; personal consumption +0.5%; retail sales +0.9%; auto sales 9.9 million units; housing starts -0.8%; housing permits -1.2%; construction expenditures -0.7%; business inventories +0.2%; orders for durable goods +1.0%; orders for nondefense capital goods +0.6%; industrial production +0.2%; CPI +0.4%; PPI +0.5%; consumption deflator +0.3%; leading indicators +0.2%; real GNP +1.9%; M1 +6.7%; M2 +7.1%.

Commentary

Employment - Initial unemployment rates have bottomed out at 325,000 while the insured unemployment rate fell slightly to 2.4% in recent weeks. Normally, this would lead to a reduction in the unemployment rate, but the rate fell an unusually large 0.3 percentage points in April. Moreover, the April survey showed surprising strength in payroll employment, although significant growth in state and local payrolls probably was a statistical aberration. Sharp declines are expected in motor vehicle employment, but the improvement in other manufacturing should lead to a 40,000 gain in overall manufacturing payrolls in May. The workweek fell surprisingly sharply in April, but a 0.5 hour reduction may be the result of the survey being taken during a week that included Passover and Good Friday. Seasonal factors simply do not adjust adequately for these holiday events. Hourly earnings remain well behaved and are only 2.2% above previous year levels. However, the manufacturing component showed a surprisingly large 0.6% gain in April, possibly indicating the end to moderation in wage demands.

Personal Income and Outlays - Farm income fell sharply in April as subsidies virtually vanished. In addition, the reduced workweek restrained wage and salary gains. A surge in wage and salary activity should be expected next month. The return to gains for property income suggests that personal income probably was understated in our recent forecast.

A surprisingly low savings rate in April was the result of unusual tax collections caused by substantial capital gains transactions on 1986 income. As tax collections revert to more normal conditions, a substantial gain is expected in disposable income and in savings during May.

Outlays were up significantly as a result of a significant gain in automobile consumption. This automobile activity conforms more closely to unit sales than the previously announced retail sales. This suggests that retail sales for April probably will be revised upward significantly when the May report is released. Expenditures on services were less than anticipated, suggesting a slowing in overall service purchases. However, growing rental rates later in the year along with higher utility rates should cause increased inflation for services activities.

In addition to sluggishness in automobile sales, reflected in dollars spent on auto dealers in the retail sales report, purchases of furniture also slowed. A substantial surge in furniture purchases early in the year probably accounts for some of this weakness. Nevertheless, slower housing activity as the year progresses probably will prevent furniture and appliances from showing significant gains. On the other hand, oil prices appear to be rising more than originally expected while meat prices also are rising more sharply early this year. While meat prices are expected to moderate late this year and early in 1988, this will still lead to higher dollar values for nondurable outlays than originally projected. A decided weakness in unit auto sales appears to be the result of reduced attractiveness of automobile incentives. However, savings may begin to increase early in 1988, suggesting that projections of auto sales could be a bit conservative.

Construction - Although single-family starts remained strong in April, permits for future single-family activity were down sharply. Permits for multi-family activity, on the other hand, showed no substantial decrease even as actual acti-

vity slumped dramatically. Little further weakness is expected in multi-family units for the remainder of this year, as those starts are now below 470,000. Higher mortgage rates and the already deteriorating permit situation suggests that single-family starts will slow significantly for the remainder of this year before an anticipated stabilizing of mortgage rates late this year leads to a slight rebound early next year. Housing activity soon will fall below 1.6 million units and will average only 1.65 million units for 1987 according to current projections.

Public construction is not as vigorous as anticipated in our forecast, largely as a result of significant downward revisions in recent activity. Activity was revised upward for nonresidential construction over the past few months, but the deterioration currently observed in orders suggests that nonresidential construction still will fall substantially for the remainder of this year. A slight rebound is anticipated early next year. Residential construction will follow housing starts downward, but with a slight lag. A significant portion of the decline in construction activity already has occurred, but another \$8 billion of construction expenditure decline is anticipated before that sector bottoms out late this year.

Business Activity - Business inventories increased significantly in March despite an unexpected decline in manufacturers' inventories. However, reduced automobile production should begin to reduce retail inventories by May and June. Manufacturing inventories are expected to rebound as a result of rising prices generating increased inventory orders.

Defense orders continued to rebound in April but are now nearly \$2 billion above shipments. Therefore, a reduction in orders is anticipated in May. In addition, reduced automobile activity should restrain transportation equipment. Also, commercial aircraft are expected to be ordered and shipped at reduced rates. However, the April durable goods orders were reasonably robust, suggesting that spending on capital goods will rise slightly even after adjustment for inflation over the next twelve months.

The weakness in industrial production seems to confirm that the hours worked were more than a holiday fluke. Automobile production is expected to fall further in May, but a rebound is expected in business equipment and in industrial materials.

Prices - The surge in commodity prices occurred at the time that the PPI survey for May was being conducted. As a result, a significant increase is expected for the PPI in finished goods. As expected, the automobile incentives were not removed from the CPI in April, although they were removed from the PPI in that month. When the incentives are partially removed in May, this will cause a significant spurt in the CPI. In addition, food prices are rising early this year as a result of an unexpected surge in meat prices. The increase in meat prices is the result of herd rebuilding, especially of hogs. While this will continue to exert upward pressures on meat prices into the summer, prices are then expected to moderate during the fall. Higher prices for oil product than originally anticipated will lead to more substantial gains for prices of industrial commodities than contained in our forecast. The forecast assumed that oil prices would average about \$18 per barrel through the year. It now appears that oil prices will average nearer \$19 and reach \$20 per barrel during the heating season.

An upward revision in the GNP deflator for the first quarter apparently occurred as a result of composition shifts in February and March. With strong gains in meat and energy prices expected in the second quarter, even modestly favorable composition shifts in that quarter will not prevent the GNP deflator from growing more than 4%. When import prices slow late in the year, the composition shift will become unfavorable, causing substantially higher GNP deflators. This will probably result in lower growth in GNP, especially early in 1988 than originally expected.

Miscellaneous - Because of the most recent increase in prices of imports associated with the dollar's decline, the merchandise trade balances probably will deteriorate noticeably in April. They will remain surprisingly high into the summer months. However, improved export volumes and decreased import volumes should eventually lead to improvements in trade balances as well late this year and early next year. Some of the gains early next year will be the result of slower economic growth than previously anticipated.

The April decline in the leading indicators was largely the result of the workweek and should rebound now that the work week will also rebound. However, the indicators probably are flat at the present time. They are expected to grow slightly after the acceleration of prices eases in the summer. A possible summer rally in the stock market also could create favorable contributions to the leading indicators. By the fall, however, the leading indicators will be trending downward, suggesting weakness in the overall economy some time in 1988.

Financial Markets

Inflationary fears that dramatically increased long-term interest rates are beginning to ease. However, a modest rally in the bond markets has spawned significant additional supply, especially in corporate and municipal offerings. This suggests that many financial officers do not believe that the current rally can be sustained. Our analysis agrees with their assessment. However, much of the increase in long-term interest rates already has been achieved. While our estimates show higher yields for long-term bonds, especially early in 1988, these increases are largely the result of slightly higher inflation rates than originally anticipated. Most short-term interest rates also are expected to increase slightly. However, a significant increase is anticipated in the discount rate by the summer months. This will lead to prime rates approaching 9% by the end of this year. Prime rates then are expected to remain at 9% for the first half of 1988.

According to our analysis from flows of funds, dramatic increases in interest rates during the spring are largely the result of changed perceptions by foreign investors. Their belief that the dollar would not be defended has led to more substantial weakness in bond prices than would have been predicted by corporate borrowings alone. However, a pickup in spending on capital goods along with continued significant accumulations of inventories are placing some upward pressures on commercial paper rates. Of course, the household sector provided the smallest contributions to credit markets in April that it ever has. However, this was the result of increased tax payments and led to reduced federal government deficits. Therefore, the net impact upon the credit markets was minimal. During the summer, government deficits will increase while house-

hold savings will rise. Continued significant gains in corporate borrowing that are not expected to be fully matched by increased corporate earnings should provide further upward pressures on short-term interest rates. In addition, if foreign investors are disillusioned by the outcome of the Venice economic summit, they could seek higher bond yields in the summer. However, the upward movement in long-term interest rates appears to be more than sufficient to reflect intensifying inflationary pressures.

Equity Markets - Clearly, equity markets no longer are receiving support from the bond market. The change in interest rates alone could justify a 12% correction in equity values. In addition, corporate earnings are being restrained by higher finance costs. However, earnings growth should be sufficiently robust to justify modest increases in equity values into the summer months. As rising bond yields are expected to resume in the fall, the stock market probably will correct decidedly by that time. Indeed, according to fundamental analysis, the stock market probably already reached its high for the year in early April. Enough technicians have failed to recognize the increased bearishness in the bond market to sustain some speculative surges in equity values. Thus, new highs in the equity markets cannot be fully ruled out, but they will soon be replaced by significant declines. By the end of 1987, the stock market probably will be fighting to remain above 2000.

Nevertheless, some issues certainly bear continued attention. Export-oriented industries still are increasing their earning capacities and may not yet be overvalued. Some of the technology issues are rebounding from a significant slump in 1985 and 1986. They have some further upside potential. On the other hand, the automobile industry, while it is import-impacted and is benefiting from the change in exchange rates, almost certainly is overvalued relative to its near term earning prospects. Indeed, most consumer related activity may be subject to a correction. Some oil related stocks have the potential for modest gains, but the surge in resource related issues, while partially justified, appears to be overdone. Certainly, interest-sensitive issues should be largely avoided until bond yields have peaked, which should not occur until late 1988 or some time in 1989. Thus, the equity markets will become much more selective with the broad averages showing little improvement over the next six months.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	101626	101626	119.9	119.9	111011	111011	6.7	6.7	170.7	170.7
February	101862	101854	120.9	121.1	111382	111382	6.7	6.7	171.4	171.4
March	102026	102009	120.4	120.6	111368	111368	6.6	6.6	171.8	171.8
April	102263	102325	120.7	120.5	111643	111835	6.5	6.3	172.2	172.2
May	102479	102590*	121.0	120.9*	111903	112036*	6.5	6.3*	172.7	172.7*
June	102695	102748	121.3	121.0	112178	112259	6.4	6.3	173.1	173.2
July	102837	102917	121.5	121.2	112321	112468	6.4	6.2	173.6	173.8
August	102973	103105	121.5	121.4	112485	112638	6.4	6.1	174.0	174.3
September	103109	103273	121.6	121.6	112286	112857	6.6	6.1	174.4	174.8
October	103295	103426	121.8	121.8	112627	113040	6.6	6.1	174.9	175.4
November	103476	103584	122.1	122.0	112917	113225	6.5	6.0	175.4	176.0
December	103654	103722	122.4	122.1	113208	113409	6.5	6.0	175.8	176.6
January 1988	103789	103885	122.5	122.3	113356	113587	6.6	6.1	176.5	177.2
February	103927	104054	122.6	122.5	113483	113795	6.7	6.0	177.3	177.9
March	104065	104216	122.5	122.7	113442	113932	6.6	6.1	178.2	178.5
April	104228	104392	122.8	122.9	113725	114105	6.5	6.1	178.6	179.0
May	104410	104584	123.2	123.1	113902	114368	6.5	6.0	179.1	179.6
June	104592	104692	123.4	123.2	114091	114433	6.5	6.1	179.6	180.2

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	3.553	3.553	2.129	2.129	118.8	118.8	3.024	3.024	2.905	2.905
February	3.599	3.598	2.145	2.146	103.2	99.4	3.075	3.070	2.972	2.971
March	3.604	3.606	2.153	2.153	105.6	97.1	3.087	3.072	2.981	2.975
April	3.619	3.616	2.163	2.161	100.3	4.3	3.095	2.998	2.995	2.993
May	3.634	3.638*	2.172	2.175*	97.2	109.5*	3.107	3.110*	3.010	3.001*
June	3.650	3.656	2.180	2.185	90.4	108.1	3.115	3.125	3.025	3.017
July	3.665	3.677	2.190	2.197	85.2	110.1	3.126	3.142	3.041	3.032
August	3.679	3.697	2.201	2.209	79.6	111.9	3.137	3.158	3.058	3.046
September	3.695	3.715	2.209	2.220	75.6	101.9	3.148	3.172	3.073	3.070
October	3.717	3.736	2.218	2.233	73.5	109.1	3.162	3.190	3.089	3.081
November	3.733	3.754	2.232	2.244	69.7	103.6	3.176	3.202	3.106	3.098
December	3.750	3.773	2.245	2.255	65.3	98.4	3.190	3.216	3.125	3.118
January 1988	3.756	3.787	2.254	2.267	85.6	114.3	3.226	3.250	3.141	3.136
February	3.779	3.808	2.264	2.282	90.3	113.1	3.243	3.270	3.153	3.157
March	3.805	3.829	2.275	2.294	99.7	118.0	3.268	3.286	3.168	3.168
April	3.824	3.848	2.286	2.306	96.3	120.9	3.285	3.301	3.189	3.180
May	3.844	3.869	2.298	2.318	93.5	125.8	3.297	3.319	3.204	3.193
June	3.863	3.890	2.307	2.330	90.4	123.6	3.310	3.336	3.220	3.212

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	2806.6	2806.6	364.8	364.8	946.8	946.8	1495.0	1495.0	2408.9	2408.9
February	2873.7	2872.4	394.3	395.2	970.0	969.4	1509.3	1507.8	2460.0	2458.2
March	2882.6	2876.8	397.2	393.7	971.6	969.2	1513.9	1513.9	2459.3	2452.7
April	2895.8	2895.0	395.1	400.8	976.5	974.0	1524.2	1520.2	2460.3	2459.7*
May	2910.0	2902.5*	394.2	391.3*	980.8	981.8*	1535.0	1529.4*	2464.0	2455.8
June	2925.4	2918.4	396.9	395.1	985.1	985.1	1543.4	1538.2	2467.7	2460.6
July	2941.0	2933.2	399.2	396.5	989.3	989.4	1552.5	1547.3	2471.4	2464.4
August	2958.5	2947.1	402.3	396.5	994.6	993.8	1561.6	1556.8	2475.7	2466.7
September	2972.7	2970.8	405.5	403.6	996.6	999.1	1570.6	1568.1	2480.0	2478.3
October	2988.2	2981.2	407.6	399.9	1000.9	1004.1	1579.7	1577.2	2481.9	2476.2
November	3005.1	2998.3	409.1	404.0	1006.5	1008.9	1589.5	1585.4	2487.7	2481.3
December	3023.9	3017.0	410.5	408.4	1013.0	1014.0	1600.4	1594.6	2493.2	2486.8
January 1988	3039.0	3034.6	412.4	410.1	1017.3	1019.0	1609.3	1605.5	2497.1	2490.5
February	3051.3	3055.3	414.4	416.7	1018.8	1023.8	1618.1	1614.8	2497.0	2496.9
March	3064.8	3065.8	416.3	413.0	1021.7	1028.5	1626.8	1624.3	2500.8	2495.6
April	3085.8	3077.3	417.8	410.3	1028.5	1031.8	1639.5	1635.2	2506.7	2494.2
May	3100.5	3089.8	417.1	407.7	1034.0	1035.3	1649.4	1646.8	2508.5	2493.7
June	3115.7	3108.3	417.0	410.8	1039.5	1041.0	1659.2	1656.5	2509.4	2497.9

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.58	118.58	20.04	20.04	8.2	8.2	74.81	74.81	23.73	23.73
February	124.41	124.28	20.76	20.40	9.9	9.9	76.73	76.92	26.93	26.97
March	124.67	125.23	20.65	20.40	10.2	10.2	76.82	76.89	27.20	27.94
April	125.04	125.38	20.80	20.35	10.0	10.4	77.20	77.34	27.04	27.69
May	125.12	124.69*	20.75	20.49*	9.6	9.6*	77.54	77.79*	26.83	26.41*
June	125.88	125.82	20.72	20.53	9.9	9.9	77.88	78.05	27.28	27.24
July	126.64	125.91	20.88	20.51	10.0	9.8	78.22	78.39	27.54	27.01
August	127.38	126.67	21.06	20.64	10.0	9.9	78.63	78.74	27.69	27.29
September	127.65	127.96	21.23	20.76	9.9	10.2	78.79	79.16	27.63	28.04
October	128.47	127.91	21.30	20.84	10.0	9.7	79.13	79.56	28.04	27.51
November	129.16	128.78	21.33	20.76	10.1	9.9	79.58	79.94	28.25	28.08
December	130.02	129.72	21.15	20.93	10.3	10.1	80.09	80.34	28.78	28.45
January 1988	130.63	130.32	21.34	21.05	10.3	10.1	80.43	80.74	28.86	28.53
February	130.92	131.06	21.45	21.13	10.3	10.2	80.55	81.12	28.92	28.81
March	131.08	131.42	21.53	21.40	10.2	10.1	80.78	81.49	28.77	28.53
April	131.97	131.35	21.57	21.35	10.2	10.0	81.31	81.75	29.09	28.25
May	132.41	131.32	21.65	21.43	10.1	9.8	81.75	82.03	29.01	27.86
June	132.85	132.14	21.62	21.52	10.1	9.9	82.18	82.48	29.05	28.14

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CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	1.816	1.816	1.253	1.253	1.690	1.690	374.8	381.1	339.0	344.6
February	1.833	1.838	1.299	1.303	1.763	1.676	378.4	383.9	341.3	346.3
March	1.774	1.749	1.245	1.226	1.757	1.719	375.2	379.0	337.7	341.2
April	1.767	1.699	1.225	1.250	1.698	1.599	375.9	377.2*	337.4	338.9*
May	1.718	1.629*	1.189	1.153*	1.653	1.542*	376.2	374.1	336.8	335.2
June	1.654	1.616	1.138	1.128	1.589	1.524	375.7	371.6	335.4	332.1
July	1.642	1.624	1.130	1.139	1.564	1.543	375.0	370.3	333.9	329.7
August	1.642	1.644	1.132	1.151	1.541	1.586	373.4	370.2	331.6	329.1
September	1.629	1.638	1.119	1.134	1.527	1.559	372.1	371.1	329.9	329.3
October	1.610	1.585	1.106	1.109	1.506	1.447	371.3	370.6	328.3	328.3
November	1.586	1.594	1.096	1.092	1.485	1.496	371.4	370.4	327.2	327.2
December	1.580	1.580	1.087	1.076	1.488	1.504	371.3	369.5	326.0	325.6
January 1988	1.618	1.561	1.105	1.085	1.531	1.448	372.4	371.3	326.1	326.6
February	1.632	1.565	1.126	1.107	1.553	1.459	373.1	371.0	326.1	325.4
March	1.607	1.572	1.108	1.105	1.528	1.465	374.4	371.4	326.4	324.9
April	1.590	1.582	1.102	1.109	1.507	1.476	376.4	373.2	327.3	325.9
May	1.589	1.596	1.109	1.123	1.493	1.493	378.6	374.7	328.4	326.4
June	1.585	1.569	1.104	1.096	1.495	1.490	380.9	376.2	328.9	324.9

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.2	121.8	75.1	73.9	181.5	185.4
February	121.0	126.1	78.0	74.8	179.4	183.0
March	118.1	121.3	75.1	73.9	182.0	183.8
April	117.4	119.7*	76.0	74.5*	182.5	183.0*
May	116.8	118.6	76.6	75.3	182.8	180.2
June	116.1	116.9	77.2	76.0	182.4	178.7
July	116.5	116.1	77.8	76.5	180.7	177.7
August	116.0	115.3	78.2	76.9	179.2	178.0
September	115.7	115.1	78.7	77.4	177.7	178.6
October	115.3	114.6	79.1	78.0	176.9	178.0
November	115.8	114.7	79.6	78.5	176.0	177.2
December	115.9	114.5	78.9	78.9	176.5	176.1
January 1988	115.7	115.9	79.6	79.4	177.1	176.0
February	115.5	115.7	80.1	79.9	177.5	175.4
March	115.8	115.6	80.7	80.2	177.9	175.6
April	116.3	115.9	81.5	80.6	178.6	176.7
May	116.8	116.2	82.3	81.3	179.5	177.2
June	117.2	116.6	83.2	81.9	180.5	177.7

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BUSINESS ACTIVITY

	Manufacturers'		Durable		Non-Defense		Non-Defense	
	Inventories		Goods Orders		Capital		Capital	
	Fore.	C.E.	Fore.	C.E.	Goods Orders	C.E.	Shipments	C.E.
January 1987	320.7	320.7	95.47	95.47	26.76	26.76	25.83	25.83
February	320.4	320.5	101.94	101.94	26.90	26.90	26.84	26.84
March	320.3	319.6	105.34	106.16	27.53	27.38	27.71	27.33
April	320.5	320.2*	102.96	106.27	26.84	27.43	27.46	26.92
May	320.8	320.7	102.43	103.88*	26.75	27.08*	27.18	27.02*
June	321.4	321.3	104.16	104.89	27.13	27.23	27.34	27.11
July	322.5	322.4	104.79	105.06	27.52	27.35	27.52	27.24
August	323.0	323.2	106.24	105.59	28.07	27.46	27.50	27.38
September	323.8	324.0	108.63	108.24	28.84	27.73	27.92	27.56
October	325.3	324.9	102.97	106.11	26.95	27.18	27.76	27.41
November	326.4	326.1	104.42	106.72	27.15	27.42	28.31	27.55
December	327.2	327.3	104.93	108.09	27.46	27.85	29.11	27.76
January 1988	329.1	329.0	106.05	107.23	27.93	27.41	27.63	27.69
February	330.6	330.5	106.17	107.50	27.86	27.53	27.85	27.78
March	331.8	331.9	105.95	106.67	27.74	27.65	28.18	27.89
April	333.6	333.3	105.24	105.88	27.05	27.62	28.65	27.95
May	335.4	335.0	103.46	104.26	25.93	26.95	28.43	26.98
June	337.4	336.8	104.21	105.31	26.28	27.18	29.06	27.43

	Business		Defense		Industrial		Capacity	
	Inventories		Shipments		Production		Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	659.0	659.0	8.27	8.28	126.5	126.5	79.4	79.4
February	660.2	660.2	8.40	8.40	127.1	127.0	79.7	79.6
March	662.8	662.8	9.87	9.87	126.7	126.8	79.2	79.3
April	662.9	665.5*	8.93	8.73	126.5	126.3	78.8	78.9
May	663.5	668.3	9.08	9.06*	127.1	126.8*	79.1	79.1*
June	664.9	669.9	9.25	9.17	127.6	127.0	79.3	79.1
July	666.8	671.9	9.20	9.20	127.8	127.2	79.3	79.1
August	668.5	674.9	9.30	9.24	127.9	127.4	79.2	79.1
September	670.6	678.0	9.34	9.30	128.1	127.7	79.2	79.2
October	673.4	681.2	9.45	9.38	128.6	127.9	79.4	79.2
November	675.9	683.4	9.40	9.35	129.0	128.1	79.5	79.2
December	678.1	686.5	9.30	9.41	129.4	128.1	79.7	79.0
January 1988	681.4	688.7	9.36	9.46	129.0	128.2	79.3	78.9
February	684.5	690.4	9.46	9.53	128.7	128.4	78.9	78.9
March	687.2	693.6	9.57	9.50	129.2	128.5	79.1	78.8
April	691.4	697.5	9.60	9.56	129.5	128.7	79.2	78.8
May	694.8	701.3	9.65	9.62	129.7	128.8	79.2	78.7
June	697.0	704.3	9.71	9.68	129.6	128.7	79.0	78.4

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PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	333.6	333.6	291.7	291.7	313.6	313.6	116.0	116.0
February	335.0	335.0	291.9	291.9	315.7	315.7	116.2	116.3
March	336.3	336.3	293.1	293.1	315.8	315.8	116.5	116.8
April	337.5	337.6	294.7	295.2	316.4	317.3	116.9	117.2
May	338.8	339.5*	296.0	297.0*	316.9	318.6*	117.3	117.7*
June	339.5	340.8	297.3	298.5	317.1	319.9	117.7	118.1
July	340.9	342.1	298.5	299.7	317.9	321.0	118.0	118.5
August	342.2	343.4	299.8	301.0	319.2	322.7	118.4	118.9
September	343.5	344.7	300.6	302.0	317.2	320.8	118.8	119.3
October	344.7	346.0	301.5	302.9	319.8	324.7	119.2	119.8
November	345.9	347.4	302.3	303.7	320.5	325.5	119.5	120.2
December	347.2	348.8	303.1	304.6	321.3	326.3	119.9	120.7
January 1988	348.2	350.1	303.8	305.5	322.9	327.4	120.4	121.2
February	349.3	351.5	304.5	306.2	324.5	328.6	121.0	121.7
March	350.4	352.9	305.2	307.0	326.0	329.9	121.6	122.2
April	351.9	354.3	306.0	307.8	325.6	331.1	121.9	122.7
May	353.7	355.8	306.9	308.5	326.5	332.0	122.2	123.1
June	355.5	357.1	307.8	309.3	327.7	333.2	122.6	123.8

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	116.5	116.5	106.0	106.0	109.2	109.2	124.8	124.8	110.6	110.6
February	116.8	116.9	106.4	106.6	109.8	109.7	125.2	125.2	110.9	110.9
March	117.2	117.3	106.4	106.8	110.2	110.3	125.6	125.6	111.1	111.1
April	117.7	117.7*	106.7	106.9*	110.7	110.9*	126.1	126.0*	111.4	111.3*
May	118.1	118.2	107.1	107.3	111.1	111.3	126.6	126.5	111.7	111.6
June	118.5	118.6	107.5	107.5	111.5	111.7	127.1	127.0	112.0	111.9
July	119.0	119.0	107.9	107.9	111.9	112.0	127.5	127.5	112.3	112.3
August	119.5	119.5	108.2	108.2	112.2	112.3	128.0	128.1	112.6	112.5
September	119.9	119.9	108.5	108.6	112.5	112.6	128.6	128.6	112.8	112.7
October	120.4	120.4	108.9	109.0	112.9	113.0	129.2	129.2	113.1	112.9
November	120.8	120.8	109.3	109.4	113.4	113.4	129.7	129.7	113.5	113.2
December	121.2	121.3	109.7	109.8	113.8	113.8	130.2	130.3	113.9	113.5
January 1988	121.7	121.8	110.0	110.1	114.2	114.3	130.7	130.9	114.2	113.7
February	122.2	122.4	110.2	110.5	114.6	114.8	131.2	131.5	114.4	114.0
March	122.6	122.8	110.5	110.9	115.0	115.1	131.8	132.1	114.7	114.3
April	123.1	123.4	110.8	111.3	115.5	115.5	132.4	132.7	115.0	114.5
May	123.6	123.9	111.2	111.7	115.9	115.9	133.0	133.3	115.3	114.8
June	124.0	124.4	111.5	112.1	116.4	116.4	133.6	133.9	115.8	115.2

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	-12.27	-12.27	186.0	185.6	4308	4316	3714	3721	-9.9	-9.9
February	-15.06	-15.06	186.8	186.3	4349	4354	3743	3744	-7.7	-7.7
March	-14.15	-13.63	187.5	187.7	4361	4372	3743	3743	-7.6	-7.6
April	-14.89	-15.20p	188.3	186.6	4372	4385	3740	3741	-8.0	-10.3
May	-14.50	-14.66*	187.8	187.5*	4398	4408	3749	3745	-8.3	-11.4
June	-14.21	-14.21	187.7	187.9	4423	4430	3758	3751	-8.6	-11.8
July	-14.96	-13.89	188.0	188.4	4440	4457	3763	3761	-9.8	-12.4
August	-14.70	-13.93	187.7	189.3	4465	4488	3771	3775	-10.2	-12.9
September	-14.44	-13.56	188.3	189.8	4491	4512	3780	3782	-9.3	-12.3
October	-14.08	-13.67	187.7	187.9	4516	4537	3789	3787	-10.5	-12.6
November	-13.91	-13.92	187.5	188.4	4535	4557	3795	3791	-10.8	-8.5
December	-13.73	-13.51	187.9	189.5	4557	4582	3801	3796	-11.1	-7.4
January 1988	-13.68	-13.26	188.4	187.8	4582	4596	3806	3792	-15.4	-7.8
February	-13.51	-12.82	188.5	187.6	4610	4620	3810	3796	-17.6	-9.1
March	-13.33	-12.54	188.2	187.3	4633	4652	3810	3807	-19.8	-9.5
April	-13.26	-12.11	187.8	187.6	4660	4686	3823	3819	-16.5	-9.6
May	-13.53	-11.89	187.3	188.1	4686	4702	3835	3820	-15.4	-9.4
June	-13.26	-11.81	187.0	188.4	4716	4727	3847	3818	-14.6	-9.8

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	258.8	258.9	737.6	737.6	2822.0	2822.0	6.43	6.43	5.44	5.44
February	259.3	259.1	737.2	737.2	2821.5	2821.5	6.10	6.10	5.59	5.59
March	260.5	260.1	739.2	739.2	2825.6	2825.6	6.13	6.13	5.60	5.60
April	262.0	261.5	750.1	750.2	2845.2	2839.6	6.38	6.37	6.05	5.90
May	263.3	263.0*	754.4	753.5*	2867.5	2853.7*	6.68	6.73*	6.11	6.18*
June	264.5	264.2	758.7	757.6	2889.3	2870.0	6.71	6.75	6.10	6.10
July	266.4	265.9	760.4	761.8	2901.4	2884.4	6.76	6.88	6.18	6.17
August	268.2	267.5	762.5	766.4	2912.9	2898.4	6.79	6.93	6.25	6.24
September	270.0	269.3	764.6	770.2	2924.3	2912.9	6.78	6.84	6.23	6.20
October	271.3	270.8	769.3	773.9	2943.2	2933.3	6.75	6.90	6.11	6.29
November	272.6	272.2	773.9	777.7	2961.9	2950.8	6.72	7.03	6.15	6.41
December	273.6	273.5	778.5	781.1	2979.7	2968.5	6.69	7.15	6.15	6.43
January 1988	275.1	274.8	784.6	784.6	2995.4	2986.3	6.57	7.07	6.01	6.35
February	276.7	276.1	790.3	789.1	3014.3	3007.2	6.55	7.20	5.98	6.47
March	278.2	278.1	796.0	795.1	3033.6	3030.1	6.61	7.25	6.06	6.50
April	280.2	280.0	800.1	800.8	3049.2	3051.8	6.76	7.23	6.17	6.44
May	282.1	281.7	804.2	805.7	3064.5	3070.5	6.88	7.21	6.30	6.40
June	284.0	283.2	807.8	810.0	3079.8	3088.9	7.01	7.27	6.32	6.45

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	8.36	8.36	6.61	6.61	5.84	5.84	5.87	5.87	7.50	7.50
February	8.38	8.38	6.61	6.61	6.05	6.05	6.10	6.10	7.50	7.50
March	8.36	8.36	6.66	6.66	6.16	6.16	6.17	6.17	7.50	7.50
April	8.93	8.85	7.56	7.55	6.43	6.45	6.56	6.52	7.74	7.75
May	9.20	9.33*	7.82	8.02*	6.72	6.78*	6.81	7.05*	8.19	8.17*
June	9.53	9.53	8.15	8.05	6.80	6.75	6.89	6.98	8.25	8.63
July	9.48	9.37	8.09	7.89	6.83	6.93	6.95	7.14	8.25	8.75
August	9.50	9.36	8.10	7.91	6.85	6.99	7.02	7.21	8.25	8.75
September	9.42	9.44	8.01	7.99	6.79	6.95	7.05	7.17	8.25	8.75
October	9.34	9.62	7.89	8.18	6.75	6.98	7.01	7.22	8.25	8.75
November	9.29	9.78	7.80	8.33	6.70	7.06	6.97	7.25	8.25	8.75
December	9.25	9.85	7.75	8.42	6.67	7.21	6.90	7.36	8.25	8.93
January 1988	9.12	9.82	7.62	8.40	6.54	7.15	6.74	7.31	8.25	9.00
February	9.15	9.89	7.62	8.46	6.57	7.18	6.75	7.35	8.25	9.00
March	9.13	9.93	7.62	8.50	6.65	7.23	6.81	7.44	8.25	9.00
April	9.32	9.82	7.85	8.38	6.78	7.26	6.99	7.48	8.25	9.00
May	9.35	9.81	7.87	8.36	6.93	7.21	7.08	7.41	8.25	9.00
June	9.43	9.74	7.97	8.29	7.04	7.25	7.22	7.45	8.25	9.00

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8/26/87 U1880-3

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MONTHLY PROJECTIONS June 1987

Dr. Donald Ratajczak, Director
For Release: July 1, 1987

INFLATION SCARE SHOULD EASE THROUGH SUMMER

After surging by 0.7% in April, the PPI has settled to only a 0.3% increase in May, and virtually all of that was the result of meat price increases. Consumer prices, which had increased at a 6% annual rate for the first four months slowed to a 4% rate in May, again with a disproportionate share of the increase caused by rising meat prices. Even a surge in commodity prices has begun to ease. The Journal of Commerce Index of Industrial prices peaked at 99.5 in mid-June and now has been trending down slightly since that time. Precious metal prices are 10% below their spring peaks while the dollar has rebounded modestly against the industrialized currencies.

Some of the slowing of inflation was expected, although the speed by which inflation has diminished is slightly surprising. Energy prices rebounded from less than \$14 per barrel late in 1986 to more than \$18 per barrel at the Persian Gulf at the present time. OPEC is apparently able to abide by production quotas sufficiently to insure that the \$18 per barrel will be preserved until the heating season. Despite problems with controlling production from Iraq, the production goals set for the fourth quarter might even generate a slight increase in oil prices. However, the pricing issue really depends upon how Saudi Arabia responds to shifting market demand conditions. If Saudi Arabia increases and decreases production to insure a constant price, as anticipated, then stable energy prices should prevail into next year. Petroleum product prices still are several cents per gallon behind what would be consistent with \$18 oil at the Persian Gulf. As the summer driving season reduces the excess oil product inventory, prices will drift upward. However, the large increase in energy-related prices already has occurred. For example, we are projecting a 16.2% increase in energy commodity prices from December 1986 to December 1987. If our June projections are correct, we already are more than 15.3% up from the December levels.

Meat prices soared earlier this year because livestock raisers were withholding animals from slaughter in order to rebuild their herds. The farrowing

intentions of hog raisers show that significant amounts of pork product probably will be available in the fall. Already, significant expansion of poultry capacity has led to a topping out of prices in that meat component. While fish prices are continuing to soar because of increased demand, beef prices should gradually diminish as supplies of pork and poultry increase. Once again, virtually all of our projection of meat price increases for the entire year have already occurred during the first six months. While food price inflation will remain significant in June, it probably will not be a significant factor during the summer.

The dollar's weakness was the third significant force generating increasing inflationary pressures early in 1987. The dollar has now rebounded, not because of any significant policy changes at the Venice economic summit, but because the Japanese have established a weekly reporting system to apply moral suasion against currency speculation. Indeed, many Japanese investors believed that the government would continue to restrain currency speculation until a 150 yen-dollar relationship was achieved. However, the weekly reporting rule has been suspended with the yen only slightly above 145, suggesting that the yen's target range is somewhat lower than had been expected. However, the Japanese did not sterilize their intervention in the currency markets, causing a significant acceleration in the growth of Japanese monetary aggregates. At the same time, the United States has gradually tightened its monetary policy. This has led to a slightly reduced excess supply of dollars relative to yen which should prevent any serious weakness in the dollar through the summer months.

Unfortunately, several members of the Federal Reserve board, especially Martha Seger and Robert Heller, continue to maintain that the Federal Reserve should currently be more concerned about sluggish growth than about inflationary flare-ups, such as the one that occurred in May. The Federal Reserve probably is following an interest rate rule during this interim period when Paul Volcker is job hunting and Alan Greenspan is not yet confirmed by the Senate. However, these board members almost certainly will try to encourage increased monetary expansion and reduced interest rates as soon as the interregnum is over. Such a policy will lead to another bout of dollar weakness in the fall and another flare-up of inflationary pressures, especially if the OPEC quotas lead to increased energy prices during the heating season. However, with inflation again diminishing during the summer, pursuit of an interest rate rule will lead to relatively modest monetary growth, thereby preserving prevailing exchange rates between the dollar and other industrialized currencies.

Also, automobile inventories still remain excessive relative to anemic sales. The industry has slowly begun abandoning incentives, which should keep sales relatively sluggish until the year-end sales programs. This will result in reduced production in order to control auto inventories. Such production declines will slow economic expansion, leading to less than 2% GNP growth according to our projections in the next two quarters. A resurgence of inflation late in the year, however, should reaccelerate industrial prices and lead to speculative increases in inventory holdings. The result will be significant gains in economic activity but that activity will be highly unbalanced. Whether the Federal Reserve responds quickly enough to dump down the new inflation risk that is anticipated at that time will determine whether growth has become sufficiently unbalanced to threaten a recession before the end of 1988.

A summer with reduced inflationary pressures should lead to slightly more favorable financial markets. Although Japanese investors were unwilling to

purchase significant amounts of the seven-year bond offered in the mini-funding, this occurred because of shifts in Japanese policy toward currency speculation. Investors in that country rightly assumed that the yen-dollar relationship would no longer improve. Even a 5 percentage point interest rate differential apparently was not enough to overcome the currency loss fears of the Japanese investor. By the time of the quarterly funding in early August, a slightly lower dollar against the yen may reduce those currency concerns. At any rate, the expansionist members of the Federal Reserve Board are expected to encourage a reduction in interest rates soon after Greenspan becomes chairman. This should result in relatively favorable conditions in the financial markets until the fall.

Quarterly Profile of GNP

	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1988-2</u>	<u>1987 Annual</u>	<u>1988 Annual</u>
Real:	4.8	1.5	2.0	2.3	3.5	2.0	2.4	2.3
Price:	4.2	4.8	4.4	4.6	4.3	4.4	3.5	4.4
Nominal:	9.1	6.4	6.5	6.9	7.9	6.6	6.0	6.8

Monthly Statistical Highlights for June 1987

Payroll employment +194,000; index of hours worked +0.2%; household employment +47,000; civilian unemployment rate 6.4%; personal income +0.6%; savings rate 3.3%; personal consumption +0.5%; retail sales +0.6%; auto sales 9.9 million units; housing starts -1.8%; housing permits +0.4%; construction expenditures -0.3%; business inventories +0.3%; orders for durable goods -2.7%; orders for nondefense capital goods +0.8%; industrial production +0.2%; CPI +0.3%; PPI +0.2%; consumption deflator +0.3%; leading indicators +0.3%; real GNP +1.0%; M1 -5.3%; M2 +2.8%.

Monthly Statistical Highlights for July 1987

Payroll employment +175,000; index of hours worked +0.2%; household employment +227,000; civilian unemployment rate 6.4%; personal income +0.5%; savings rate 3.3%; personal consumption +0.6%; retail sales +0.6%; auto sales 9.9 million units; housing starts -1.3%; housing permits -1.4%; construction expenditures -0.4%; business inventories +0.3%; orders for durable goods -1.4%; orders for nondefense capital goods -2.1%; industrial production +0.2%; CPI +0.3%; PPI +0.3%; consumption deflator +0.3%; leading indicators +0.2%; real GNP +1.3%; M1 +6.4%; M2 +6.4%.

Commentary

Employment - The June employment survey is unusually early in the month and probably will result in a lower estimate of civilian employment gains than would have occurred with a differently timed survey. In addition, the reduced number

of weeks between surveys should restrain the growth of payroll employment. The latest benchmark revisions substantially reduced the growth of payroll employment during the first part of the year. The sharp drop in hours worked originally estimated between February and March was eliminated. The revisions also led to a slower rate of increase in the hourly earnings index than had previously been anticipated. The actual surge in manufacturing wages was eliminated upon revision. Thus, fears of renewed wage inflation are not justified at the present time. On the other hand, some acceleration in wage pressures should be generated from the increased inflationary pressures that developed early in the year.

Personal Income and Outlays - Farm income fell to a surprisingly low \$11 billion in May as no crop support programs were available. As the winter wheat harvest progresses, however, subsidies should rise. Moreover, the spring increase in short-term interest rates is beginning to be reflected in property incomes. Therefore, the relatively modest rates of growth in personal income in the last two months will give way to stronger growth in the summer.

As expected, tax collections returned to more normal levels following capital gains payments in April. However, the savings rate is unusually low, but consumers are unlikely to increase their savings until asset values end their upward movement. This explains why our projections of savings show little change until the first of next year and then gradually intensify. Of course, tax liabilities also distort the savings pattern over the year, as changes in indexation are calculated in the early months of the year. This normally leads to lower estimates of tax liabilities early in the year followed by rising tax liabilities later on.

There has been virtually no increase in transfers and interest payments by consumers since the first of the year. However, the increase in interest rates during the spring probably should increase the interest component.

Weakness in sales both for automobiles and furniture caused a significant decline in durable goods outlays in May. A slight rebound in automobile sales and an anticipated rebound in furniture sales should cause stronger outlays for consumption in June. Nondurables also were surprisingly modest despite reasonably strong gains for nondurable retail activity. This suggests that the energy components, especially fuel oil, were unusually low. Such reductions in spending patterns should not persist, leading to a significant rebound in nondurables during June. A modest rebound also is expected in service expenditures, although financial commissions are expected to remain sluggish. Although real consumption expenditures in May apparently fell significantly, consumer spending in the second quarter still will exceed first quarter averages because of the surprisingly dramatic reduction in durable consumption spending during January.

Construction - Housing permits in May fell more sharply than anticipated although starts were close to expectations. Most of the weakness in permits was in single-family activity, suggesting further weakness in single-family starts in the months ahead. Multi-family activity appears to be developing a range of activity between 450,000 and 480,000 units. This relatively modest rate of multi-family activity is expected to persist through the remainder of this year. The weakness in single-family starts probably reflects financing fears about housing as a result of the sharp increase in mortgage rates during late April and early May. Mortgage rates are expected to drift downward during the summer, but the damage probably is done for single-family starts at the present time.

Construction expenditures were revised upward early this year as public construction and residential construction both were stronger than originally recorded. Public construction should continue to rebound significantly as a result of increased highway financing. Also, many state and local governments have captured the tax windfall associated with federal tax changes. Nonresidential construction has continued to perform stronger than anticipated, but the latest F. W. Dodge report for May shows that construction contracts for nonresidential activity fell 8%. Construction should continue to be a drag upon economic activity into the early months of 1988 when, barring any significant increase in mortgage rates, the construction correction should gradually bottom out.

Business Activity - Although inventory accumulation probably will be less during the second quarter than in the first quarter, factories now are accumulating inventories. In addition, production of automobiles suggests that auto inventories will rise slightly further, although not at the rate they increased in the first quarter. Auto inventory liquidations then are expected during the summer months.

The surprisingly strong report for durable goods was the result of a smaller decline in defense shipments than had been expected and a significant gain in commercial aircraft orders. These commercial aircraft orders probably will not be available in June. In addition, further declines in defense orders could be anticipated. The strong gains in nondefense capital goods orders have not been reflected in increased capital shipments. Although capital spending will be up during the second quarter because of surprising weakness early in the year, the rate of increase is relatively modest.

On the other hand, industrial production rebounded nicely in May after upward revisions in the previous months. The industrial sector now is performing well in comparison to a year ago. Auto assemblies were only 7.1 million units in May and, still, industrial production was able to increase 0.5%. This suggests that reasonable gains in industrial production should be anticipated through the summer months even as further production curtailment in the auto industry begins to whittle away the excess inventories there.

Prices - As mentioned above, inflationary pressures are receding following a significant spurt in the winter and early spring months. Commodity inflation should moderate significantly during the summer before reaccelerating modestly in the fall. As a result, the CPI probably will grow by less than 4% in the summer months. This also will cause a moderation in the consumption deflator. However, the surge in the deflator during the second quarter may lead to higher estimates for the GNP deflator than originally expected. Inflation rates then will moderate significantly during the summer months.

Miscellaneous - The trade balances were more favorable in April than had been anticipated. This was caused both by a significant increase in exports and surprisingly little expansion in imports as a result of a decline in oil imports. Our current production and consumption levels suggests that we require nearly 210 million barrels of imported oil a month. Yet, in April, imports were only 168 million. Furthermore, import prices are continuing to rise. For that reason, further significant gains in our trade balances will be difficult over the next several months. However, the expansion in exports is encouraging and suggests that greater improvement in our trade balances will be achieved than had been expected in our May forecast.

The leading indicators should continue to perform well during the summer as inflation slows and as the stock market probably continues to generate favorable results. More difficult problems should develop in the fall although building permits may not be showing further weakness at that time. Indeed, the indicator components could rise moderately over the next twelve months as there appears to be no significant bunching of weak components. Some of the sectors showing weakness currently should have their weakness bottoming out even as other sectors begin to correct.

Financial Markets

Although manufacturers are continuing to rebuild their inventories, the reduction in automobile inventories should exert downward pressures upon corporate borrowing during the summer months. Reductions in mortgage financing should increase the amount of funds provided by the household sector, but the government sector probably will experience a rise in deficits following unexpected tax collections from capital gains. Nevertheless, the flow of funds suggest that interest rates could decline modestly during the summer excluding the behavior of foreign investors. If the dollar remains relatively stable as a result of earlier monetary restraint, as expected, foreign investors probably will continue to willingly provide capital. If so, interest rates could move downward slightly.

Of course, I am assuming that the expansion-minded members of the Federal Reserve will eventually succeed in encouraging a lower federal funds target soon after Chairman Greenspan is confirmed. However, this will lead to an acceleration in money growth and begin to undermine the dollar's strength in currency markets. By the fall, the resumed weakness of the dollar might then lead to increased inflationary pressures resulting in a Federal Reserve response. At that time, the Federal Reserve probably would allow an increase in the discount rate and this would lead to higher bank lending rates.

Early in 1988 increased inflationary pressures could lead to increased speculative holdings of inventories. This, in turn, would lead to higher short-term interest rates. Yields on long-term government bonds are expected to reach 9% late this year and continue to provide yield through much of 1988.

Equity Markets - Operating profits are rebounding significantly during the summer months as wage levels continue to remain modest. However, increased interest rate burdens are limiting the degree to which profitability is rising. Interest rates are expected to fall in the summer, which should combine with rising earnings to lead to higher equity values. However, the equity markets really did not sell off on the upward pressures of interest rates in the spring. Thus, equity values probably are currently excessive for projected earnings potential. Nevertheless, a summer increase in equity values is likely because of the moderation of interest rates and the modest strengthening in the value of the dollar. Technology stocks still hold some prospects for increased valuation, as their production levels are rebounding from recessionary activity. However, cyclical stocks probably will only continue to progress until the speculative inventory holdings of industrial materials begins in earnest early in 1988. Interest sensitive issues may also rebound in the summer but should fall when interest rates begin rising in the fall.

It now appears that the equity markets will continue to rise during the summer and could reach as high as 2700 on the Dow. During the fall, however, rising interest rates should reduce prospects of further gains. The stock market still is expected to sell off significantly and struggle to remain above 2000 during its fall and winter slide. A more severe contraction than that is not anticipated at the present time, however.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	101626	100919	119.9	118.7	111011	111011	6.7	6.7	170.7	171.2
February	101862	101150	120.9	119.7	111382	111382	6.7	6.7	171.4	171.8
March	102026	101329	120.4	119.6	111368	111368	6.6	6.6	171.8	172.2
April	102263	101609	120.7	119.6	111643	111835	6.5	6.3	172.2	172.5
May	102479	101732	121.0	120.1	111903	112447	6.5	6.3	172.7	172.6
June	102695	101926*	121.3	120.3*	112178	112480*	6.4	6.4*	173.1	173.0*
July	102837	102101	121.5	120.5	112321	112707	6.4	6.4	173.6	173.4
August	102973	102373	121.5	120.8	112485	113036	6.4	6.3	174.0	173.8
September	103109	102568	121.6	121.0	112286	113392	6.6	6.1	174.4	174.2
October	103295	102840	121.8	121.3	112627	113453	6.6	6.1	174.9	174.7
November	103476	103095	122.1	121.6	112917	113693	6.5	6.0	175.4	175.0
December	103654	103291	122.4	121.8	113208	113895	6.5	6.0	175.8	175.6
January 1988	103789	103493	122.5	122.0	113356	114079	6.6	5.9	176.5	176.4
February	103927	103606	122.6	122.1	113483	114227	6.7	6.0	177.3	177.0
March	104065	103797	122.5	122.3	113442	114429	6.6	6.0	178.2	177.6
April	104228	104008	122.8	122.5	113725	114651	6.5	6.1	178.6	178.2
May	104410	104194	123.2	122.7	113902	114820	6.5	6.1	179.1	178.8
June	104592	104373	123.4	122.9	114091	115016	6.5	6.0	179.6	179.4

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	3.553	3.553	2.129	2.129	118.8	118.8	3.024	3.024	2.905	2.905
February	3.599	3.598	2.145	2.146	103.2	99.4	3.075	3.070	2.972	2.971
March	3.604	3.609	2.153	2.155	105.6	104.7	3.087	3.076	2.981	2.971
April	3.619	3.622	2.163	2.162	100.3	3.1	3.095	2.993	2.995	2.990
May	3.634	3.630	2.172	2.171	97.2	101.8	3.107	3.094	3.010	2.992
June	3.650	3.651*	2.180	2.182*	90.4	104.2*	3.115	3.112*	3.025	3.008*
July	3.665	3.671	2.190	2.192	85.2	103.7	3.126	3.129	3.041	3.025
August	3.679	3.692	2.201	2.205	79.6	100.0	3.137	3.146	3.058	3.046
September	3.695	3.709	2.209	2.215	75.6	99.2	3.148	3.159	3.073	3.060
October	3.717	3.730	2.218	2.229	73.5	105.0	3.162	3.176	3.089	3.071
November	3.733	3.748	2.232	2.239	69.7	102.0	3.176	3.190	3.106	3.088
December	3.750	3.770	2.245	2.252	65.3	98.9	3.190	3.208	3.125	3.109
January 1988	3.756	3.789	2.254	2.268	85.6	117.8	3.226	3.244	3.141	3.126
February	3.779	3.808	2.264	2.279	90.3	123.3	3.243	3.265	3.153	3.142
March	3.805	3.830	2.275	2.291	99.7	122.5	3.268	3.285	3.168	3.163
April	3.824	3.851	2.286	2.304	96.3	129.7	3.285	3.303	3.189	3.173
May	3.844	3.870	2.298	2.317	93.5	127.3	3.297	3.318	3.204	3.191
June	3.863	3.893	2.307	2.331	90.4	128.9	3.310	3.337	3.220	3.208

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	2806.6	2803.1	364.8	364.9	946.8	946.4	1495.0	1491.8	2408.9	2405.7
February	2873.7	2872.4	394.3	395.2	970.0	969.4	1509.3	1507.8	2460.0	2458.2
March	2882.6	2873.2	397.2	389.9	971.6	964.5	1513.9	1518.8	2459.3	2450.2
April	2895.8	2891.8	395.1	399.1	976.5	966.0	1524.2	1526.7	2460.3	2455.0
May	2910.0	2893.3	394.2	393.2	980.8	967.2	1535.0	1532.9	2464.0	2445.8*
June	2925.4	2909.1*	396.9	394.2*	985.1	975.1*	1543.4	1539.8*	2467.7	2451.0
July	2941.0	2925.9	399.2	396.3	989.3	981.0	1552.5	1548.6	2471.4	2456.2
August	2958.5	2947.0	402.3	402.7	994.6	986.5	1561.6	1557.8	2475.7	2466.1
September	2972.7	2960.6	405.5	402.1	996.6	991.7	1570.6	1566.8	2480.0	2467.3
October	2988.2	2971.5	407.6	397.0	1000.9	998.7	1579.7	1575.8	2481.9	2466.1
November	3005.1	2988.2	409.1	400.1	1006.5	1002.7	1589.5	1585.4	2487.7	2471.1
December	3023.9	3009.0	410.5	404.4	1013.0	1008.1	1600.4	1596.5	2493.2	2478.2
January 1988	3039.0	3025.8	412.4	407.1	1017.3	1012.8	1609.3	1605.9	2497.1	2483.6
February	3051.3	3041.0	414.4	409.5	1018.8	1017.6	1618.1	1613.9	2497.0	2486.9
March	3064.8	3061.5	416.3	413.1	1021.7	1023.6	1626.8	1624.8	2500.8	2494.0
April	3085.8	3072.0	417.8	411.4	1028.5	1027.1	1639.5	1633.5	2506.7	2492.4
May	3100.5	3089.1	417.1	413.0	1034.0	1032.8	1649.4	1643.3	2508.5	2497.4
June	3115.7	3106.1	417.0	416.6	1039.5	1036.9	1659.2	1652.6	2509.4	2500.4

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.58	118.58	20.04	20.04	8.2	8.2	74.81	74.81	23.73	23.73
February	124.41	124.28	20.76	20.40	9.9	9.9	76.73	76.92	26.93	26.97
March	124.67	124.59	20.65	20.16	10.2	10.2	76.82	76.65	27.20	27.78
April	125.04	124.79	20.80	19.97	10.0	10.4	77.20	76.82	27.04	28.00
May	125.12	124.03	20.75	19.86	9.6	9.7	77.54	77.25	26.83	26.93
June	125.88	124.73*	20.72	19.93*	9.9	9.9*	77.88	77.64*	27.28	27.16*
July	126.64	125.45	20.88	19.96	10.0	9.9	78.22	78.11	27.54	27.38
August	127.38	126.66	21.06	20.07	10.0	10.2	78.63	78.55	27.69	28.04
September	127.65	126.99	21.23	19.91	9.9	10.2	78.79	78.96	27.63	28.12
October	128.47	126.94	21.30	19.83	10.0	9.6	79.13	79.52	28.04	27.59
November	129.16	127.64	21.33	19.99	10.1	9.7	79.58	79.84	28.25	27.81
December	130.02	128.58	21.15	20.08	10.3	9.9	80.09	80.27	28.78	28.23
January 1988	130.63	129.27	21.34	19.95	10.3	10.1	80.43	80.64	28.86	28.68
February	130.92	129.94	21.45	20.13	10.3	10.1	80.55	81.02	28.92	28.79
March	131.08	130.85	21.53	20.21	10.2	10.3	80.78	81.50	28.77	29.14
April	131.97	130.92	21.57	20.16	10.2	10.2	81.31	81.78	29.09	28.98
May	132.41	131.57	21.65	20.29	10.1	10.2	81.75	82.23	29.01	29.05
June	132.85	132.32	21.62	20.46	10.1	10.3	82.18	82.56	29.05	29.30

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	1.816	1.816	1.253	1.253	1.690	1.690	374.8	381.1	339.0	344.6
February	1.833	1.838	1.299	1.303	1.763	1.676	378.4	386.8	341.3	348.9
March	1.774	1.749	1.245	1.226	1.757	1.719	375.2	382.4	337.7	344.3
April	1.767	1.665	1.225	1.222	1.698	1.598	375.9	384.1	337.4	345.6
May	1.718	1.620	1.189	1.129	1.653	1.477	376.2	381.7*	336.8	342.6*
June	1.654	1.591*	1.138	1.115*	1.589	1.483*	375.7	380.7	335.4	340.8
July	1.642	1.570	1.130	1.096	1.564	1.462	375.0	379.3	333.9	338.7
August	1.642	1.595	1.132	1.117	1.541	1.483	373.4	378.7	331.6	336.9
September	1.629	1.618	1.119	1.125	1.527	1.516	372.1	379.2	329.9	336.8
October	1.610	1.576	1.106	1.104	1.506	1.501	371.3	378.4	328.3	335.5
November	1.586	1.590	1.096	1.112	1.485	1.482	371.4	379.0	327.2	335.4
December	1.580	1.575	1.087	1.098	1.488	1.465	371.3	378.3	326.0	333.9
January 1988	1.618	1.545	1.105	1.083	1.531	1.428	372.4	378.3	326.1	333.0
February	1.632	1.553	1.126	1.088	1.553	1.443	373.1	377.6	326.1	332.1
March	1.607	1.570	1.108	1.102	1.528	1.458	374.4	377.9	326.4	331.5
April	1.590	1.576	1.102	1.105	1.507	1.472	376.4	379.7	327.3	332.5
May	1.589	1.598	1.109	1.121	1.493	1.496	378.6	382.2	328.4	333.8
June	1.585	1.578	1.104	1.106	1.495	1.493	380.9	382.7	328.9	333.4

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.2	121.8	75.1	73.9	181.5	185.4
February	121.0	126.4	78.0	75.5	179.4	184.9
March	118.1	121.3	75.1	76.4	182.0	184.7
April	117.4	123.7	76.0	76.2	182.5	184.2
May	116.8	122.9*	76.6	76.5*	182.8	182.3*
June	116.1	122.6	77.2	77.3	182.4	180.8
July	116.5	122.4	77.8	77.5	180.7	179.4
August	116.0	121.7	78.2	77.9	179.2	179.1
September	115.7	120.9	78.7	78.4	177.7	179.9
October	115.3	120.3	79.1	78.8	176.9	179.3
November	115.8	120.1	79.6	79.4	176.0	179.5
December	115.9	120.2	78.9	79.8	176.5	178.3
January 1988	115.7	119.6	79.6	80.5	177.1	178.2
February	115.5	119.8	80.1	80.9	177.5	176.9
March	115.8	119.8	80.7	81.4	177.9	176.7
April	116.3	120.4	81.5	81.7	178.6	177.6
May	116.8	120.6	82.3	82.3	179.5	179.3
June	117.2	121.1	83.2	82.7	180.5	178.9

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	320.7	320.7	95.47	95.47	26.76	26.76	25.83	25.83
February	320.4	320.5	101.94	101.93	26.90	26.86	26.84	26.80
March	320.3	320.1	105.34	106.15	27.53	27.37	27.71	27.34
April	320.5	320.8	102.96	106.93	26.84	28.30	27.46	27.33
May	320.8	321.8*	102.43	106.85	26.75	29.95	27.18	27.25
June	321.4	322.6	104.16	103.96*	27.13	28.93*	27.34	27.48*
July	322.5	323.4	104.79	102.49	27.52	28.31	27.52	27.73
August	323.0	324.3	106.24	104.43	28.07	28.96	27.50	28.22
September	323.8	325.3	108.63	107.26	28.84	29.21	27.92	28.46
October	325.3	326.4	102.97	104.13	26.95	27.64	27.76	27.58
November	326.4	327.5	104.42	103.85	27.15	27.52	28.31	27.69
December	327.2	328.8	104.93	105.43	27.46	28.11	29.11	27.88
January 1988	329.1	330.5	106.05	106.11	27.93	28.27	27.63	28.13
February	330.6	332.4	106.17	106.84	27.86	28.43	27.85	28.31
March	331.8	333.9	105.95	108.27	27.74	28.92	28.18	28.49
April	333.6	335.2	105.24	108.92	27.05	29.12	28.65	28.45
May	335.4	336.7	103.46	108.53	25.93	29.18	28.43	28.86
June	337.4	338.0	104.21	109.58	26.28	29.43	29.06	29.16

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	659.0	659.0	8.27	8.28	126.5	126.5	79.4	79.4
February	660.2	660.5	8.40	8.40	127.1	127.2	79.7	79.7
March	662.8	663.0	9.87	9.87	126.7	127.3	79.2	79.6
April	662.9	664.3	8.93	8.75	126.5	127.2	78.8	79.4
May	663.5	666.9*	9.08	9.20	127.1	127.8	79.1	79.6
June	664.9	668.8	9.25	9.23*	127.6	128.1*	79.3	79.7*
July	666.8	670.5	9.20	9.28	127.8	128.3	79.3	79.7
August	668.5	672.1	9.30	9.35	127.9	128.6	79.2	79.8
September	670.6	675.0	9.34	9.53	128.1	128.8	79.2	79.8
October	673.4	679.5	9.45	9.47	128.6	129.2	79.4	80.0
November	675.9	681.8	9.40	9.50	129.0	129.5	79.5	80.0
December	678.1	684.3	9.30	9.53	129.4	129.7	79.7	80.0
January 1988	681.4	687.9	9.36	9.58	129.0	129.9	79.3	80.0
February	684.5	692.3	9.46	9.62	128.7	129.9	78.9	79.8
March	687.2	695.4	9.57	9.67	129.2	130.2	79.1	79.9
April	691.4	698.1	9.60	9.73	129.5	130.4	79.2	79.9
May	694.8	701.2	9.65	9.80	129.7	130.6	79.2	79.9
June	697.0	703.9	9.71	9.85	129.6	130.9	79.0	80.0

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	333.6	333.6	291.7	291.7	313.6	313.5	116.0	116.0
February	335.0	335.0	291.9	291.9	315.7	315.7	116.2	116.3
March	336.3	336.3	293.1	293.1	315.8	315.8	116.5	116.8
April	337.5	337.6	294.7	295.2	316.4	317.4	116.9	117.3
May	338.8	338.7	296.0	296.1	316.9	318.6	117.3	117.8
June	339.5	339.7*	297.3	296.7*	317.1	319.2*	117.7	118.1*
July	340.9	340.6	298.5	297.5	317.9	320.1	118.0	118.6
August	342.2	341.5	299.8	298.3	319.2	321.6	118.4	119.0
September	343.5	342.9	300.6	299.5	317.2	319.3	118.8	119.4
October	344.7	344.3	301.5	300.7	319.8	322.9	119.2	119.9
November	345.9	345.5	302.3	301.6	320.5	324.0	119.5	120.3
December	347.2	346.9	303.1	303.0	321.3	325.3	119.9	120.8
January 1988	348.2	348.0	303.8	303.8	322.9	326.5	120.4	121.2
February	349.3	349.4	304.5	304.9	324.5	327.8	121.0	121.6
March	350.4	350.9	305.2	306.1	326.0	329.3	121.6	122.0
April	351.9	352.2	306.0	307.0	325.6	330.5	121.9	122.5
May	353.7	353.5	306.9	307.9	326.5	331.6	122.2	122.9
June	355.5	355.1	307.8	309.0	327.7	332.8	122.6	123.4

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	116.5	116.5	106.0	106.0	109.2	109.2	124.8	124.8	110.6	110.6
February	116.8	116.8	106.4	106.5	109.8	109.7	125.2	125.2	110.9	110.9
March	117.2	117.3	106.4	106.7	110.2	110.2	125.6	125.6	111.1	111.1
April	117.7	117.8	106.7	106.9	110.7	110.9	126.1	126.1	111.4	111.2
May	118.1	118.3*	107.1	107.2*	111.1	111.4*	126.6	126.6*	111.7	111.4*
June	118.5	118.7	107.5	107.6	111.5	111.8	127.1	127.0	112.0	111.7
July	119.0	119.1	107.9	107.9	111.9	112.2	127.5	127.5	112.3	112.0
August	119.5	119.5	108.2	108.2	112.2	112.5	128.0	128.0	112.6	112.4
September	119.9	120.0	108.5	108.5	112.5	112.9	128.6	128.6	112.8	112.6
October	120.4	120.5	108.9	109.0	112.9	113.2	129.2	129.2	113.1	112.8
November	120.8	120.9	109.3	109.3	113.4	113.6	129.7	129.7	113.5	113.0
December	121.2	121.4	109.7	109.7	113.8	114.0	130.2	130.3	113.9	113.3
January 1988	121.7	121.8	110.0	110.1	114.2	114.3	130.7	130.8	114.2	113.6
February	122.2	122.3	110.2	110.5	114.6	114.7	131.2	131.3	114.4	113.7
March	122.6	122.8	110.5	110.8	115.0	115.1	131.8	131.9	114.7	114.0
April	123.1	123.3	110.8	111.1	115.5	115.5	132.4	132.5	115.0	114.2
May	123.6	123.7	111.2	111.4	115.9	115.9	133.0	133.0	115.3	114.5
June	124.0	124.2	111.5	111.8	116.4	116.4	133.6	133.6	115.8	114.8

Fore. = May Forecast

C.E. = Current Expectations

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	-12.27	-12.27	186.0	185.6	4308	4316	3714	3721	-9.9	-9.6
February	-15.06	-15.06	186.8	186.3	4349	4359	3743	3748	-7.7	-7.0
March	-14.15	-13.63	187.5	187.7	4361	4380	3743	3750	-7.6	-7.1
April	-14.89	-13.32	188.3	186.6	4372	4397	3740	3749	-8.0	-9.6
May	-14.50	-13.27p	187.8	187.5	4398	4423	3749	3755	-8.3	-10.5
June	-14.21	-13.06*	187.7	188.0*	4423	4438	3758	3758	-8.6	-11.3
July	-14.96	-12.27	188.0	188.3	4440	4462	3763	3762	-9.8	-11.7
August	-14.70	-12.83	187.7	188.6	4465	4485	3771	3769	-10.2	-11.5
September	-14.44	-12.94	188.3	188.7	4491	4522	3780	3787	-9.3	-11.0
October	-14.08	-13.36	187.7	188.1	4516	4545	3789	3791	-10.5	-9.4
November	-13.91	-12.83	187.5	188.3	4535	4560	3795	3791	-10.8	-9.2
December	-13.73	-12.81	187.9	188.0	4557	4589	3801	3799	-11.1	-8.6
January 1988	-13.68	-12.52	188.4	187.8	4582	4626	3806	3817	-15.4	-8.8
February	-13.51	-13.53	188.5	188.1	4610	4656	3810	3829	-17.6	-9.2
March	-13.33	-12.67	188.2	188.4	4633	4678	3810	3834	-19.8	-9.5
April	-13.26	-12.52	187.8	187.8	4660	4695	3823	3833	-16.5	-9.8
May	-13.53	-12.17	187.3	187.5	4686	4732	3835	3850	-15.4	-10.4
June	-13.26	-11.85	187.0	187.8	4716	4757	3847	3855	-14.6	-10.8

Fore. = May Forecast

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* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	258.8	258.9	737.6	737.6	2822.0	2822.0	6.43	6.43	5.44	5.44
February	259.3	259.0	737.2	737.2	2821.5	2821.5	6.10	6.10	5.59	5.59
March	260.5	260.1	739.2	739.2	2825.6	2825.7	6.13	6.13	5.60	5.60
April	262.0	262.2	750.1	750.2	2845.2	2839.6	6.38	6.37	6.05	5.90
May	263.3	263.6	754.4	753.3	2867.5	2844.8	6.68	6.85	6.11	6.05
June	264.5	264.2*	758.7	749.9*	2889.3	2851.4*	6.71	6.72*	6.10	6.04*
July	266.4	265.5	760.4	753.8	2901.4	2866.2	6.76	6.73	6.18	6.00
August	268.2	267.4	762.5	761.8	2912.9	2889.6	6.79	6.36	6.25	5.83
September	270.0	268.8	764.6	766.6	2924.3	2909.8	6.78	6.27	6.23	5.76
October	271.3	269.8	769.3	770.3	2943.2	2926.8	6.75	6.51	6.11	5.94
November	272.6	271.0	773.9	772.9	2961.9	2940.7	6.72	6.73	6.15	5.98
December	273.6	272.5	778.5	776.4	2979.7	2954.0	6.69	6.85	6.15	6.03
January 1988	275.1	273.9	784.6	778.4	2995.4	2968.8	6.57	6.83	6.01	6.11
February	276.7	275.3	790.3	783.2	3014.3	2987.1	6.55	7.04	5.98	6.24
March	278.2	276.6	796.0	786.9	3033.6	3008.0	6.61	7.16	6.06	6.27
April	280.2	277.8	800.1	789.5	3049.2	3023.0	6.76	7.25	6.17	6.29
May	282.1	279.3	804.2	793.2	3064.5	3041.1	6.88	7.23	6.30	6.25
June	284.0	280.8	807.8	797.5	3079.8	3062.4	7.01	7.26	6.32	6.28

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	8.36	8.36	6.61	6.61	5.84	5.84	5.87	5.87	7.50	7.50
February	8.38	8.38	6.61	6.61	6.05	6.05	6.10	6.10	7.50	7.50
March	8.36	8.36	6.66	6.66	6.16	6.16	6.17	6.17	7.50	7.50
April	8.93	8.85	7.56	7.55	6.43	6.45	6.56	6.52	7.74	7.75
May	9.20	9.33	7.82	8.00	6.72	6.93	6.81	6.99	8.19	8.14
June	9.53	9.33*	8.15	7.81*	6.80	6.85*	6.89	6.92*	8.25	8.25*
July	9.48	9.08	8.09	7.54	6.83	6.80	6.95	6.86	8.25	8.25
August	9.50	8.82	8.10	7.29	6.85	6.64	7.02	6.75	8.25	8.25
September	9.42	8.96	8.01	7.35	6.79	6.60	7.05	6.71	8.25	8.25
October	9.34	9.13	7.89	7.58	6.75	6.67	7.01	6.78	8.25	8.25
November	9.29	9.35	7.80	7.78	6.70	6.85	6.97	6.93	8.25	8.46
December	9.25	9.52	7.75	7.95	6.67	7.02	6.90	7.13	8.25	8.67
January 1988	9.12	9.56	7.62	8.01	6.54	7.05	6.74	7.16	8.25	8.75
February	9.15	9.53	7.62	8.01	6.57	7.09	6.75	7.20	8.25	8.75
March	9.13	9.48	7.62	7.92	6.65	7.16	6.81	7.25	8.25	8.75
April	9.32	9.45	7.85	7.87	6.78	7.29	6.99	7.38	8.25	8.75
May	9.35	9.43	7.87	7.85	6.93	7.28	7.08	7.39	8.25	8.75
June	9.43	9.28	7.97	7.70	7.04	7.33	7.22	7.43	8.25	8.93

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MONTHLY PROJECTIONS

July 1987

Dr. Donald Ratajczak, Director
For Release: July 29, 1987

DATA REVISIONS INCREASE IMPORTANCE OF SERVICE ECONOMY

According to the latest annual revisions of the GNP, service purchases have been significantly understated over the past three years. Much of this is the result of sharp gains in rental activity, especially for home entertainment items such as videos, which have not been adequately incorporated in the regular spending surveys. Because of data revisions, economic activity in the first quarter was 0.9% higher after inflation than originally reported.

Construction expenditures also were revised significantly upward, with the brunt of this revision occurring in the additions and alterations of residential activity. This segment of construction expenditures now accounts for more than one-quarter of total construction spending. As a result, the relationship between housing starts and construction expenditures needs to be adjusted modestly. The construction deflator also was revised upward, but the overall GNP deflator was virtually unchanged. Because of shifts in composition, the implicit deflator for consumer durables was lower than originally recorded while the consumer services index was slightly higher. However, the overall consumption deflator was little changed from previous estimates. Moreover, our estimates of the overall GNP deflator showed little change.

Capital spending grew about a percentage point per year less than originally expected over the past three years while inventory holdings are about a percentage point higher than reported in the unrevised data. Thus, business inventories have not been depleted as rapidly as earlier expected, although the rate of inventory accumulation slowed in the second quarter as auto inventories were no longer being accumulated.

Personal income also was revised upward sharply. The increase in consumer outlays had no adverse effect upon personal savings. Indeed, a more than \$20 billion upward revision in wages and salaries and a more than \$40 billion increase in interest income were more than sufficient to offset increased ser-

vice outlays. However, these income gains were at the expense of corporate earnings. Indeed, our stock market formula would suggest an even greater vulnerability to decreases in stock values than was the case with the previously reported data.

While economic activity was being revised upward, employment and the index of hours worked had been revised downward as a result of their benchmark adjustments. Thus, productivity has not been as anemic as originally reported. Nevertheless, productivity gains still remain very modest in comparison to gains during the 1950's and 1960's. There also may be a slight distortion in the manufacturing productivity data. In recent years, a rising percentage of all manufacturing employment has been procured by lease or using temporaries. However, this renting of labor services is counted in the service sector rather than in the manufacturing sector. As a result, the amount of resources in manufacturing that are being used to provide manufacturing activity are diminished relative to the amount of activity that is being accomplished. This causes a significant increase in manufacturing productivity at the expense of productivity performance in the service economy.

Because of upward revisions in economic activity and downward revisions in capital spending over the previous three years, an upward revision in capacity utilization may be forthcoming. Even so, the utilization level should remain only slightly above 80%. However, as industrial activity continues to expand, increased spending on plant and equipment may develop. Thus, growth in producers' durables may combine with reductions in the trade deficit to provide significant economic stimulus in the next six to twelve months even as consumer spending grows at reduced rates.

Normally, a slowing in construction activity and some moderation in inventory accumulation would lead to some softening in interest rate pressures. However, the Federal Reserve apparently has "snugged" up as growth in the monetary base has slowed sharply in the past three months. In addition, higher interest rates have increased the attractiveness of noncheckable deposits for holding short-term liquidity. This has caused the money multiplier to fall, leading to virtually no growth in monetary aggregates over the past three months. Indeed, the Federal Reserve probably is currently following an interest rate target rule while the confirmation of Alan Greenspan continues to be discussed in the Senate. The softening of economic activity when an interest rate rule is used generally leads to reduced growth in monetary aggregates as the Federal Reserve is put in the unexpected position of propping up short-term interest rates.

Despite downward pressures upon short-term interest rates, long-term interest rates continue to increase. Inflationary concerns remain near the surface, while a run-up in the price of oil early in July accounted for some of the poor interest rate performance. Later in July, concerns began to be raised about foreign reception of the government funding and the huge supply of bonds and notes that will need to be absorbed following resolution of the latest debt limitation crisis.

The latest concern about foreign investors is caused by a modest narrowing of interest rate differentials between Japan and the United States. As the dollar has rallied against the yen in the past month, and is now trading around the 150 yen range, potential further appreciation of the dollar is expected to be minimal. The prevailing 4 percentage point differential between yields on

Japanese and American debt instruments may not provide enough insurance to offset fears of dollar declines in the future. Therefore, Japanese investors may not be as aggressive in bidding for American securities as in the past. Moreover, rapid money growth in Japan during recent months has begun to stimulate domestic activity there. As a result, the quantity of savings available for foreign investments may diminish slightly. Nevertheless, unusually high yields on U.S. government securities, approaching 9%, should entice lenders in the United States to enter the market. After all, the inflation rate probably has slowed to a 4% path for the next six to twelve months, suggesting that an unusually high return adjusted for inflation currently exists in U.S. government bonds.

Although supply problems are substantial and will probably prevent any significant rebound in government bond prices before the middle of August, developing favorable near-term trends in the inflationary outlook should prove to be beneficial to fixed income investors. Our PPI survey for July shows no change in prices of finished goods. The Journal of Commerce index of industrial prices currently is moving down toward 98 from a high of slightly over 100 early in July. Moreover, the hourly earnings index continues to show only very modest increases from the previous year, growing only 2.3% from a year ago in the latest reporting month.

While the longer term trend for interest rates is probably upward, rates have increased more rapidly than fundamentals have deteriorated. For that reason, a slight rally in the bond market should be anticipated by the beginning of fall.

Quarterly Profile of GNP

	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1988-2</u>	<u>1988-3</u> Annual	<u>1988</u> Annual
Real:	4.4	2.6	3.0	2.5	2.5	2.3	2.6	2.5
Price:	4.3	3.8	4.2	4.5	4.4	4.4	3.6	4.4
Nominal:	8.9	6.5	7.3	7.1	7.0	6.7	6.3	7.0

Monthly Statistical Highlights for July 1987

Payroll employment +167,000; index of hours worked +0.2%; household employment +261,000; civilian unemployment rate 6.3%; personal income +0.5%; savings rate 4.1%; personal consumption +0.5%; retail sales +0.3%; auto sales 10.0 million units; housing starts +0.1%; housing permits -1.1%; construction expenditures -0.6%; business inventories +0.5%; orders for durable goods +0.4%; orders for nondefense capital goods +2.3%; industrial production +0.2%; CPI +0.3%; PPI -0.0%; consumption deflator +0.4%; leading indicators +0.3%; real GNP (AR) +4.5%; M1 (AR) +0.6%; M2 (AR) +5.1%.

Monthly Statistical Highlights for August 1987

Payroll employment +166,000; index of hours worked +0.2%; household employment +153,000; civilian unemployment rate 6.3%; personal income +0.6%;

savings rate 4.2%; personal consumption +0.4%; retail sales +0.2%; auto sales 10.1 million units; housing starts +0.2%; housing permits +0.6%; construction expenditures +0.6%; business inventories +0.5%; orders for durable goods -1.6%; orders for nondefense capital goods -1.7%; industrial production +0.2%; CPI +0.3%; PPI +0.1%; consumption deflator +0.3%; leading indicators +0.2%; real GNP (AR) +1.6%; M1 (AR) +5.3%; M2 (AR) +6.2%.

Commentary

Employment - As expected, the unusually early survey caused a drop in household employment in June and a significant drop in the teenage unemployment rate. In addition, payroll employment grew more slowly than in previous months. However, along with distortions caused by the unusually early survey, some signs of reduced employment demand surfaced. The workweek shortened slightly and reduced growth in payrolls was even sharper than could be explained by an unusually short survey period. The survey in July is relatively late in the month, which should generate higher than normal payroll employment. However, the reduced demand for labor input may restrain employment growth. In particular, employment gains are beginning to slow in the previously hot areas of eating out and business services. The household report will show a rebound in employment with a much larger rebound in the labor force as teenage unemployment moves back to where it was in May. As a result, the unemployment rate will rise and the report will appear slightly weak.

Nevertheless, the diffusion index continues to reveal modest growth, especially when the shortened survey period is considered. In addition, the hourly earnings index remains only 2.3% above previous year levels and shows no tendency to accelerate at the present time.

Personal Income and Outlays - As mentioned above, revisions in personal income were approximately \$20 billion in wages and salaries, \$5 billion in rental income, \$40 billion in interest income, and more than \$20 billion in farm income. Because of the sharp upward revision in farm income, there was less room for gains from shifts in farm subsidies. Thus, growth in personal income for June was less than anticipated, but such anticipations would have not been as robust if revised incomes had been known. The June report also showed an unusual \$4 billion drop in social security outlays. Obviously, such a decline is not anticipated in July.

Also as mentioned above, most of the increased outlays from the revised data were in the service sector. However, a large increase in home improvement materials also caused a significant upward revision in durables. Hot weather and a reinvigorated stock market caused a significant rebound in services during June. Similar growth in service expenditures may be forthcoming in July before the service component moderates during the fall. Expenditures for nondurables are surprisingly weak especially as prices have begun intensifying for gasoline and food product. Apparently, a significant decline in the volume of gasoline and fuel oil sales is occurring. As energy prices stabilize in the second half of the year, the volume of petroleum product expenditures should resume modest upward growth.

Automobile sales appear to be stuck at 10 million units despite efforts to stimulate sales with incentives. A new burst of incentives is expected to close

out the model year in September. The sales surge, however, is not expected to be as dramatic as last year, although it will be borrowing from sales in the next few months. With more than 135 million registered automobiles, replacement demand probably is approaching 10 million units. Thus, auto sales should gradually improve following the incentive distortions anticipated at the end of this model year.

Furniture sales are beginning to weaken notably as a result of the weakness in housing activity. Because housing is expected to fall further in the latter part of 1987, furniture sales should remain weak into the first part of 1988. This is a significant deviation from our previous forecast, but it is necessitated by the dramatic slowing in housing activity following increased mortgage rates during April and May.

Construction - Housing sales fell dramatically in May as a result of a sharp increase in interest rates. A modest sales rebound probably developed in June, although the data are not yet available. Single-family activity fell sharply in May and June in response to this weak sales environment. A slight rebound in activity is now anticipated as buyers become more accepting of double-digit mortgage rates. Nevertheless, no significant resurgence is anticipated. Apartment activity was stronger than expected in June, but this appears to be a temporary rebound, as permits for rental units fell significantly. Our current projections suggest that most of the damage already has occurred in housing starts, but the lagged response of expenditures to these changes in starts will continue to exert downward pressures upon construction expenditures through the summer.

Revisions in construction expenditures were largely in the residential area and are largely related to alterations and additions. As a result, a higher constant term is required to generate construction expenditures from housing starts. The result of this is to permanently increase the level of construction expenditures relative to housing activity. On the other hand, public construction has stalled despite increased outlays for highway activity. This appears to be the result of budgetary restraints that will continue to exert a moderating influence upon public construction during the next year. The rebound in nonresidential construction during May is surprising and appears to be at least partially concentrated in shopping centers and other retail activity. Commercial activity is falling. Although some industrial growth is anticipated, weakness in retail construction should exert downward pressures upon nonresidential expenditures in the remainder of the year.

The upward revision in prices for construction product also increased the growth of construction prices over the first five months. As a result, higher construction deflators are necessary in our projections. This, of course, means that construction dollars will not be as easily translated into real activity as prior to the revision.

Business Activity - The surprising spurt in wholesale inventories during May was primarily responsible for the better GNP gains in the second quarter than originally anticipated. Indeed, our estimates of changes in final demand were precisely the 3.3% reported for the quarter. Although automobile inventories were not accumulated, manufacturing parts at the wholesale level grew sharply. This appears to be in response to increased delivery delays and rising prices for industrial materials. Now that those prices are beginning to moderate, business inventories probably will grow more slowly during the summer months. However,

increased manufacturing activity will require an increase in manufacturers' inventories. The effect will be a moderation in inventory investment in the third quarter, but only by a small amount.

Defense orders continued to swell and are now more than \$1.3 billion above shipments. This will accelerate the growth of shipments next year, but will also require a slowing in defense orders in the months ahead. Thus, there should be little further gain in durable goods orders in the next twelve months. Orders for nondefense capital goods have been vacillating as a result of intermittent large orders for commercial aircraft. Aircraft orders were relatively light in June but should rematerialize in July. Of course, these aircraft orders should have limited effect upon shipments of capital goods in the months ahead. Nevertheless, the buildup of a backlog will cause further increases in capital shipments. Thus, capital spending activity is now expected to grow more than 3% after adjustment for inflation in the next twelve months.

The strength in durable goods activity and in inventory accumulations will be reflected in stronger gains for industrial production than anticipated in our previous forecast. The industrial sector is expected to grow almost as rapidly as overall GNP, a far cry from a year ago when a 2.9% increase in GNP corresponded with only a 0.6% gain in the industrial production index.

Prices - Price revisions in the new GNP accounts were relatively modest. Those that occurred already have been explained above. It now appears that inflationary pressures are diminishing despite slightly further gains in petroleum product. However, oil should only sell between \$1.5 - \$2 above the Persian Gulf wellhead price in the United States. Given the \$18 wellhead price, this would mean a price below \$20. However, tension in the Persian Gulf caused a premium on oil prices. This premium will slowly diminish as it becomes clear that oil will be flowing freely in that part of the world. Thus, the oil shock probably is behind us for the remainder of this year. In addition, the meat shock is rapidly coming to an end. Although prices of industrial materials are continuing to rise unusually rapidly, inflationary dangers probably will diminish in the second half of this year.

Miscellaneous - The trade deficit in May was less than forecast but more than anticipated following further dollar weakening and the favorable April trade performance. Oil imports rebounded but so did automobiles. However, automobile imports may be the beginning of a Japanese model year. Further increases are anticipated in oil imports but other imports of manufactured goods should begin to decline. The dollar's strength should lower overall trade deficits next year.

The leading indicators should continue to grow rapidly as sharp gains in sensitive prices offset significant declines in the real money stock. If the stock market peaks toward the fall, as expected, and if sensitive prices begin to moderate, the leading indicators should top out some time in the fall.

Financial Markets

The result of the data revisions is to show greater corporate need for funds than had previously been expected. Although fixed investment is not as robust, inventory investment is more substantial. In addition, corporate cash flow appears to be less than originally anticipated. This is partially offset

by higher savings in the household sector, although increased consumption diminishes the magnitude of savings improvement there. Thus, the data revisions reveal a greater need for funds by domestic private industry than previously expected. This may partially explain the vigor by which interest rates moved up in the spring when new inflationary fears surfaced.

Corporate profits should grow substantially during the second half of 1987 while inventory investments should show minimal change. Although fixed investment will continue to expand, this suggests that the corporate sector will be exerting less pressures upon interest rates than previously. Although the government will be borrowing significantly following its unexpected revenue gains as a result of capital gains transactions during the spring, most of this increased government deficit will be mirrored by increased household savings. Thus, the net near-term effect of the deficit on interest rate increases in the summer will be modest. With mortgage borrowings declining as a result of reduced housing demand, the household sector will significantly increase its net contribution to the credit markets. This means that foreign use of funds will be much less significant in the summer and fall than originally anticipated. Indeed, such an economic environment could justify a modest decline in interest rates.

Also, the Federal Reserve has become more restrictive in recent months. Monetary aggregates are growing well below Federal Reserve targets and the monetary base has slowed to less than a 6% growth path over the past thirteen weeks. Currency demand remains relatively vigorous, suggesting that much of the slowing in monetary aggregates is merely the result of shifting savings portfolios. Nevertheless, the Federal Reserve probably will feel that restraint is no longer needed at the present time. When corporate borrowing needs diminish slightly, this could lead to declining short-term interest rates in the fall. These rates are not expected to decline dramatically and should reverse direction and begin rising again early in 1988.

It should also be noted that the decline in deficits will be coming to an end after only a one-year downward trend. Unless significant budgetary restraint or revenue-raising activity develops in 1988, an unlikely event during an election year, the government deficit probably will rise about \$10 billion from an anticipated \$160 billion level in the current fiscal year.

On the other hand, the household sector probably will continue to restrain housing purchases and gradually rebuild savings accounts. Thus, the household sector's contribution to credit market conditions may nearly offset the government's increased desire for borrowings. If the corporate sector modestly reduces its need for funds, the bond markets will have less reliance upon foreign investments. However, economic conditions probably will again reassert upward pressures upon interest rates early in 1988.

Equity Markets - According to data revisions, stock market values already are excessive. However, earnings are improving dramatically while expected interest rates are no longer increasing. Under those conditions, a modestly higher stock market evaluation is certainly possible. However, this improved equity evaluation will only continue until interest rates begin moving upward again and earnings begin to show weakened year over year comparisons by the beginning of 1988.

The dollar's rebound in recent weeks reduces opportunities in the chemicals and forest products industries. In addition, the retrenchment expected by the

consumer suggests that consumer-based products will have diminished opportunities. Even interest-sensitive securities will be struggling late this year and early next year as interest rates continue to rise.

However, some of the cyclical industrial material companies, such as plastics, rubber, and even the nonprecious nonferrous metals may do reasonably well in the next twelve months. In addition, capital goods producers may receive increased valuations. Thus, opportunities still remain in the equity markets, but the range of opportunities is clearly diminishing. A decline in equity values still is anticipated late this year and early in 1988, when the stock market may fall toward the 2000 level.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	101626	100919	119.9	118.7	111011	111011	6.7	6.7	170.7	171.2
February	101862	101150	120.9	119.7	111382	111382	6.7	6.7	171.4	171.8
March	102026	101329	120.4	119.6	111368	111368	6.6	6.6	171.8	172.2
April	102263	101598	120.7	119.6	111643	111835	6.5	6.3	172.2	172.6
May	102479	101672	121.0	120.2	111903	112447	6.5	6.3	172.7	172.7
June	102695	101788	121.3	120.1	112178	112257	6.4	6.1	173.1	173.1
July	102837	101953*	121.5	120.3*	112321	112418*	6.4	6.3*	173.6	173.5*
August	102973	102119	121.5	120.5	112485	112571	6.4	6.3	174.0	173.9
September	103109	102247	121.6	120.6	112286	112870	6.6	6.2	174.4	174.4
October	103295	102349	121.8*	120.7	112627	112975	6.6	6.2	174.9	174.8
November	103476	102545	122.1	120.9	112917	113211	6.5	6.2	175.4	175.3
December	103654	102749	122.4	121.1	113208	113597	6.5	6.0	175.8	175.7
January 1988	103789	102971	122.5	121.3	113356	113604	6.6	6.1	176.5	176.2
February	103927	103141	122.6	121.5	113483	113784	6.7	6.1	177.3	176.7
March	104065	103378	122.5	121.8	113442	114033	6.6	6.0	178.2	177.3
April	104228	103565	122.8	122.0	113725	114246	6.5	5.9	178.6	177.7
May	104410	103753	123.2	122.2	113902	114454	6.5	5.9	179.1	178.2
June	104592	103864	123.4	122.3	114091	114540	6.5	5.9	179.6	178.8

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	3.553	3.632	2.129	2.150	118.8	150.3	3.024	3.094	2.905	2.943
February	3.599	3.671	2.145	2.166	103.2	128.6	3.075	3.138	2.972	3.010
March	3.604	3.683	2.153	2.173	105.6	136.4	3.087	3.146	2.981	3.010
April	3.619	3.700	2.163	2.182	100.3	32.9	3.095	3.067	2.995	3.034
May	3.634	3.718	2.172	2.193	97.2	146.4	3.107	3.176	3.010	3.030
June	3.650	3.731	2.180	2.201	90.4	122.3	3.115	3.173	3.025	3.050
July	3.665	3.751*	2.190	2.211*	85.2	130.0*	3.126	3.195*	3.041	3.065*
August	3.679	3.772	2.201	2.222	79.6	134.1	3.137	3.212	3.058	3.078
September	3.695	3.790	2.209	2.231	75.6	113.4	3.148	3.221	3.073	3.108
October	3.717	3.808	2.218	2.240	73.5	142.3	3.162	3.240	3.089	3.098
November	3.733	3.827	2.232	2.251	69.7	135.4	3.176	3.254	3.106	3.119
December	3.750	3.848	2.245	2.262	65.3	133.1	3.190	3.270	3.125	3.137
January 1988	3.756	3.860	2.254	2.273	85.6	145.5	3.226*	3.300	3.141	3.155
February	3.779	3.880	2.264	2.285	90.3	155.1	3.243	3.323	3.153	3.168
March	3.805	3.903	2.275	2.299	99.7	153.3	3.268	3.343	3.168	3.185
April	3.824	3.923	2.286	2.310	96.3	160.4	3.285	3.360	3.189	3.200
May	3.844	3.942	2.298	2.321	93.5	154.2	3.297	3.373	3.204	3.219
June	3.863	3.963	2.307	2.333	90.4	152.2	3.310	3.388	3.220	3.236

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	2806.6	2849.5	364.8	381.9	946.8	954.4	1495.0	1513.2	2408.9	2446.7
February	2873.7	2915.8	394.3	405.7	970.0	980.3	1509.3	1529.8	2460.0	2496.9
March	2882.6	2916.0	397.2	400.7	971.6	975.1	1513.9	1540.1	2459.3	2484.3
April	2895.8	2939.7	395.1	411.6	976.5	979.3	1524.2	1548.8	2460.3	2497.0
May	2910.0	2935.9	394.2	403.8	980.8	977.3	1535.0	1554.7	2464.0	2481.2
June	2925.4	2956.3	396.9	413.6	985.1	974.4	1543.4	1568.3	2467.7	2488.1*
July	2941.0	2971.2*	399.2	413.7*	989.3	979.6*	1552.5	1577.9*	2471.4	2491.0
August	2958.5	2983.4	402.3	413.9	994.6	982.1	1561.6	1587.4	2475.7	2492.5
September	2972.7	3012.8	405.5	430.8	996.6	985.4	1570.6	1596.6	2480.0	2509.8
October	2988.2	3002.6	407.6	407.9	1000.9	989.0	1579.7	1605.7	2481.9	2490.5
November	3005.1	3023.3	409.1	414.5	1006.5	993.4	1589.5	1615.4	2487.7	2498.1
December	3023.9	3041.3	410.5	417.2	1013.0	997.8	1600.4	1626.3	2493.2	2503.9
January 1988	3039.0	3058.5	412.4	419.9	1017.3	1002.8	1609.3	1635.8	2497.1	2509.2
February	3051.3	3071.6	414.4	420.3	1018.8	1006.2	1618.1	1645.1	2497.0	2509.6
March	3064.8	3088.1	416.3	423.5	1021.7	1009.9	1626.8	1654.7	2500.8	2513.8
April	3085.8	3102.6	417.8	424.0	1028.5	1013.5	1639.5	1665.1	2506.7	2515.8
May	3100.5	3121.4	417.1	427.4	1034.0	1018.2	1649.4	1675.8	2508.5	2521.3
June	3115.7	3137.9	417.0	428.7	1039.5	1023.0	1659.2	1686.2	2509.4	2523.9

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.58	118.58	20.04	20.04	8.2	8.2	74.81	74.81	23.73	23.73
February	124.41	124.28	20.76	20.40	9.9	9.9	76.73	76.92	26.93	26.97
March	124.67	124.59	20.65	20.16	10.2	10.2	76.82	76.65	27.20	27.78
April	125.04	124.96	20.80	20.03	10.0	10.4	77.20	76.83	27.04	28.10
May	125.12	124.55	20.75	20.07	9.6	9.7	77.54	76.86	26.83	27.61
June	125.88	125.08	20.72	19.98	9.9	9.9	77.88	76.97	27.28	28.13
July	126.64	125.50*	20.88	19.86*	10.0	10.0*	78.22	77.38*	27.54	28.26*
August	127.38	125.72	21.06	19.80	10.0	10.1	78.63	77.58	27.69	28.34
September	127.65	127.95	21.23	19.85	9.9	10.8	78.79	77.84	27.63	30.26
October	128.47	125.57	21.30	19.79	10.0	9.5	79.13	78.12	28.04	27.66
November	129.16	126.68	21.33	19.70	10.1	9.8	79.58	78.47	28.25	28.51
December	130.02	127.35	21.15	19.84	10.3	9.9	80.09	78.82	28.78	28.69
January 1988	130.63	128.05	21.34	19.71	10.3	10.1	80.43	79.21	28.86	29.13
February	130.92	128.37	21.45	19.63	10.3	10.1	80.55	79.48	28.92	29.26
March	131.08	128.98	21.53	19.60	10.2	10.3	80.78	79.72	28.77	29.56
April	131.97	129.38	21.57	19.57	10.2	10.3	81.31	80.06	29.09	29.75
May	132.41	130.15	21.65	19.64	10.1	10.4	81.75	80.43	29.01	30.08
June	132.85	130.68	21.62	19.68	10.1	10.4	82.18	80.81	29.05	30.19

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	320.7	320.7	95.47	95.47	26.76	26.76	25.83	25.83
February	320.4	320.5	101.94	101.93	26.90	26.86	26.84	26.80
March	320.3	320.1	105.34	106.21	27.53	27.40	27.71	27.35
April	320.5	320.8	102.96	106.93	26.84	28.30	27.46	27.33
May	320.8	321.5	102.43	106.98	26.75	29.99	27.18	26.95
June	321.4	321.9*	104.16	108.53	27.13	29.09	27.34	27.61
July	322.5	322.5	104.79	108.96*	27.52	29.76*	27.52	27.88*
August	323.0	323.2	106.24	107.23	28.07	29.24	27.50	28.13
September	323.8	324.1	108.63	105.92	28.84	28.63	27.92	28.16
October	325.3	324.9	102.97	105.51	26.95	27.84	27.76	27.95
November	326.4	326.2	104.42	106.65	27.15	28.63	28.31	28.16
December	327.2	327.5	104.93	107.41	27.46	28.89	29.11	28.43
January 1988	329.1	328.8	106.05	107.14	27.93	28.36	27.63	28.05
February	330.6	329.9	106.17	107.69	27.86	28.65	27.85	28.62
March	331.8	331.3	105.95	109.23	27.74	29.15	28.18	28.69
April	333.6	332.2	105.24	109.85	27.05	29.63	28.65	29.13
May	335.4	333.1	103.46	108.76	25.93	29.54	28.43	29.28
June	337.4	334.5	104.21	109.78	26.28	29.65	29.06	29.46

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	659.0	659.0	8.27	8.28	126.5	126.5	79.4	79.4
February	660.2	660.5	8.40	8.40	127.1	127.2	79.7	79.7
March	662.8	663.0	9.87	9.87	126.7	127.3	79.2	79.6
April	662.9	665.9	8.93	8.76	126.5	127.3	78.8	79.4
May	663.5	670.4	9.08	9.23	127.1	128.0	79.1	79.7
June	664.9	673.6*	9.25	9.36	127.6	128.2	79.3	79.7
July	666.8	677.1	9.20	9.51*	127.8	128.5*	79.3	79.8*
August	668.5	680.2	9.30	9.66	127.9	128.8	79.2	79.9
September	670.6	682.9	9.34	9.64	128.1	129.0	79.2	79.9
October	673.4	684.9	9.45	9.53	128.6	129.1	79.4	79.8
November	675.9	688.3	9.40	9.60	129.0	129.5	79.5	80.0
December	678.1	691.7	9.30	9.58	129.4	129.9	79.7	80.1
January 1988	681.4	694.6	9.36	9.62	129.0	130.2	79.3	80.2
February	684.5	698.0	9.46	9.67	128.7	130.6	78.9	80.4
March	687.2	702.6	9.57	9.75	129.2	131.1	79.1	80.6
April	691.4	705.5	9.60	9.83	129.5	131.4	79.2	80.7
May	694.8	708.1*	9.65	9.89	129.7	131.7	79.2	80.7
June	697.0	709.6	9.71	9.96	129.6	132.0	79.0	80.8

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI Finished Goods		PPI-Industrial Commodities		Estimated GNP Deflator	
	(seasonally adjusted)		(seasonally adjusted)		(unadjusted)			
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	333.6	333.6	291.7	291.7	313.6	313.5	116.0	115.8
February	335.0	335.0	291.9	291.9	315.7	314.9	116.2	116.1
March	336.3	336.4	293.1	293.2	315.8	315.8	116.5	116.5
April	337.5	337.9	294.7	295.3	316.4	317.4	116.9	116.9
May	338.6	339.0	296.0	296.2	316.9	318.6	117.3	117.2
June	339.5	340.4	297.3	296.8	317.1	320.2	117.7	117.6
July	340.9	341.4*	298.5	296.7*	317.9	321.8*	118.0	118.0*
August	342.2	342.5	299.8	297.0	319.2	321.5	118.4	118.4
September	343.5	343.5	300.6	296.9	317.2	319.2	118.8	118.8
October	344.7	345.0	301.5	298.5	319.8	322.7	119.2	119.3
November	345.9	346.1	302.3	299.1	320.5	323.8	119.5	119.7
December	347.2	347.5	303.1	300.2	321.3	325.0	119.9	120.1
January 1988	348.2	348.6	303.8	301.1	322.9	326.2	120.4	120.5
February	349.3	350.0	304.5	302.3	324.5	327.5	121.0	121.0
March	350.4	351.1	305.2	302.9	326.0	328.3	121.6	121.4
April	351.9	352.5	306.0	304.1	325.6	329.9	121.9	121.9
May	353.7	353.9	306.9	305.3	326.5	331.0	122.2	122.3
June	355.5	355.3	307.8	306.5	327.7	331.9	122.6	122.8

	Consumption Deflator		Consumer Durables		Consumer Nondurables		Consumer Services		Implicit Construction Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	116.5	116.5	106.0	104.9	109.2	109.3	124.8	125.1	110.6	111.9
February	116.8	116.8	106.4	105.5	109.8	109.6	125.2	125.6	110.9	113.0
March	117.2	117.4	106.4	105.7	110.2	110.5	125.6	126.0	111.1	113.7
April	117.7	117.7	106.7	106.0	110.7	111.1	126.1	126.2	111.4	113.8
May	118.1	118.3	107.1	105.9	111.1	111.8	126.6	126.8	111.7	114.0
June	118.5	118.8*	107.5	106.2*	111.5	112.3*	127.1	127.4*	112.0	114.2*
July	119.0	119.3	107.9	106.4	111.9	112.8	127.5	127.9	112.3	114.3
August	119.5	119.7	108.2	106.7	112.2	113.1	128.0	128.4	112.6	114.6
September	119.9	120.0	108.5	107.1	112.5	113.4	128.6	128.9	112.8	115.0
October	120.4	120.6	108.9	107.4	112.9	113.7	129.2	129.4	113.1	115.2
November	120.8	121.0	109.3	107.7	113.4	114.1	129.7	130.0	113.5	115.5
December	121.2	121.5	109.7	108.0	113.8	114.5	130.2	130.5	113.9	115.7
January 1988	121.7	121.9	110.0	108.3	114.2	114.9	130.7	131.0	114.2	116.0
February	122.2	122.4	110.2	108.7	114.6	115.4	131.2	131.5	114.4	116.2
March	122.6	122.8	110.5	108.9	115.0	115.9	131.8	132.0	114.7	116.5
April	123.1	123.3	110.8	109.1	115.5	116.3	132.4	132.6	115.0	116.9
May	123.6	123.8	111.2	109.4	115.9	116.7	133.0	133.2	115.3	117.2
June	124.0	124.3	111.5	109.7	116.4	117.2	133.6	133.8	115.8	117.5

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

MISCELLANEOUS

	Merchandise		Leading		Estimated		Estimated		IVA	
	Trade Balance		Indicators		GNP		GNP (1982 \$)		(annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.F.
January 1987	-12.27	-12.27	186.0	185.6	4308	4346	3714	3753	9.9	-14.6
February	-15.06	-15.07	186.8	186.3	4349	4385	3743	3777	-7.7	-9.6
March	-14.15	-13.63	187.5	187.7	4361	4402	3743	3779	7.6	-9.7
April	-14.89	-13.32	188.3	186.6	4372	4420	3740	3781	-8.0	-14.9
May	-14.50	-14.40	187.8	187.5	4398	4452	3749	3799	-8.3	-19.6
June	-14.21	-14.00p	187.7	188.0	4423	4474	3758	3804	-8.6	21.0
July	-14.96	-13.26*	188.0	188.6*	4440	4495*	3763	3818*	9.8	22.7*
August	-14.70	-13.63	187.7	188.9	4465	4527	3771	3823	-10.2	-20.3
September	-14.44	-13.29	188.3	189.4	4491	4552	3780	3832	-9.3	-16.5
October	-14.08	-13.53	187.7	189.0	4516	4576	3789	3836	-10.5	-14.2
November	-13.91	-12.96	187.5	188.6	4535	4608	3795	3850	-10.8	-11.6
December	-13.73	-12.85	187.9	189.1	4557	4635	3801	3859	-11.1	-11.9
January 1988	-13.68	-12.29	188.4	188.7	4582	4656	3806	3863	-15.4	-12.5
February	-13.51	-13.41	188.5	188.2	4610	4682	3810	3870	-17.6	-12.8
March	-13.33	-12.58	188.2	187.8	4633	4715	3810	3884	-19.8	-15.3
April	-13.26	-12.26	187.8	187.2	4660	4739	3823	3888	-16.5	-18.1
May	-13.53	-13.05	187.3	188.0	4686	4764	3835	3895	-15.4	-16.6
June	-13.26	-12.57	187.0	188.3	4716	4788	3847	3899	-14.6	-15.2

Fore. = May Forecast

C.E. = Current Expectations

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CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	1.816	1.816	1.253	1.253	1.690	1.690	374.8	384.7	339.0	343.9
February	1.833	1.838	1.299	1.303	1.763	1.676	378.4	401.6	341.3	355.3
March	1.774	1.749	1.245	1.226	1.757	1.719	375.2	388.3	337.7	341.5
April	1.767	1.699	1.225	1.250	1.698	1.599	375.9	397.3	337.4	349.2
May	1.718	1.602	1.189	1.119	1.653	1.493	376.2	398.6	336.8	349.6
June	1.654	1.590	1.138	1.092	1.589	1.514	375.7	394.0*	335.4	345.0*
July	1.642	1.592*	1.130	1.116*	1.564	1.498*	375.0	391.8	333.9	342.8
August	1.642	1.595	1.132	1.122	1.541	1.507	373.4	389.5	331.6	339.9
September	1.629	1.595	1.119	1.113	1.527	1.501	372.1	389.6	329.9	338.8
October	1.610	1.580	1.106	1.107	1.506*	1.473	371.3	389.7	328.3	338.3
November	1.586	1.593	1.096	1.123	1.485	1.488	371.4	389.3	327.2	337.1
December	1.580	1.548	1.087	1.095	1.488	1.427	371.3	390.5	326.0	337.5
January 1988	1.618	1.558	1.105	1.086	1.531	1.439	372.4	390.4	326.1	336.6
February	1.632	1.553	1.126	1.080	1.553	1.462	373.1	390.2	326.1	335.8
March	1.607	1.561	1.108	1.089	1.528	1.471	374.4	389.9	326.4	334.7
April	1.590	1.552	1.102	1.076	1.507	1.456	376.4	390.2	327.3	333.8
May	1.589	1.559	1.109	1.082	1.493	1.463	378.6	391.3	328.4	333.9
June	1.585	1.582	1.104	1.094	1.495	1.489	380.9	392.4	328.9	334.0

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.2	122.4	75.1	74.5	181.5	187.8
February	121.0	123.4	78.0	75.2	179.4	203.1
March	118.1	121.4	75.1	76.1	182.0	190.8
April	117.4	121.4	76.0	76.7	182.5	199.2
May	116.8	123.8	76.6	75.8	182.8	198.9
June	116.1	123.0*	77.2	76.1*	182.4	194.9*
July	116.5	122.4	77.8	76.5	180.7	192.9
August	116.0	121.8	78.2	76.4	179.2	191.3
September	115.7	120.9	78.7	77.0	177.7	191.7
October	115.3	120.3	79.1	77.3	176.9	192.1
November	115.8	120.0	79.6	77.6	176.0	191.7
December	115.9	120.4	78.9	78.1	176.5	192.0
January 1988	115.7	120.1	79.6	78.6	177.1	191.7
February	115.5	119.7	80.1	78.8	177.5	191.7
March	115.8	119.4	80.7	79.4	177.9	191.1
April	116.3	119.0	81.5	80.0	178.6	191.2
May	116.8	119.6	82.3	80.3	179.5	191.4
June	117.2	119.5	83.2	80.8	180.5	192.1

Fore. = May Forecast

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* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	258.8	258.9	737.6	737.7	2822.0	2822.2	6.43	6.43	5.44	5.44
February	259.3	259.0	737.2	737.5	2821.5	2821.5	6.10	6.10	5.59	5.59
March	260.5	260.1	739.2	739.5	2825.6	2824.7	6.13	6.13	5.60	5.60
April	262.0	262.2	750.1	750.4	2845.2	2839.1	6.38	6.37	6.05	5.90
May	263.3	263.4	754.4	753.2	2867.5	2840.1	6.68	6.85	6.11	6.05
June	264.5	263.8	758.7	746.7	2889.3	2842.8	6.71	6.73	6.10	5.99
July	266.4	264.3*	760.4	747.1*	2901.4	2854.6*	6.76	6.52*	6.18	5.67*
August	268.2	265.1	762.5	750.3	2912.9	2868.9	6.79	6.33	6.25	5.53
September	270.0	265.9	764.6	753.0	2924.3	2883.2	6.78	6.27	6.23	5.41
October	271.3	266.7	769.3	754.8	2943.7	2892.1	6.75	6.22	6.11	5.40
November	272.6	268.3	773.9	760.9	2961.9	2908.3	6.72	6.27	6.15	5.46
December	273.6	269.9	778.5	765.4	2979.7	2925.5	6.69	6.38	6.15	5.58
January 1988	275.1	271.6	784.6	771.6	2995.4	2943.1	6.57	6.55	6.01	5.73
February	276.7	273.3	790.3	777.0	3014.3	2963.7	6.55	6.62	5.98	5.81
March	278.2	274.9	796.0	783.2	3033.6	2984.4	6.61	6.76	6.06	5.92
April	280.2	276.7	800.1	789.4	3049.2	3005.3	6.76	6.88	6.17	6.01
May	282.1	278.4	804.2	794.8	3064.5	3023.3	6.88	6.85	6.30	6.06
June	284.0	280.1	807.8	798.8	3079.8	3039.9	7.01	6.97	6.32	6.11

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	8.36	8.36	6.61	6.61	5.84	5.84	5.87	5.87	7.50	7.50
February	8.38	8.38	6.61	6.61	6.05	6.05	6.10	6.10	7.50	7.50
March	8.36	8.36	6.66	6.66	6.16	6.16	6.17	6.17	7.50	7.50
April	8.93	8.85	7.56	7.55	6.43	6.45	6.56	6.52	7.74	7.75
May	9.20	9.33	7.82	8.00	6.72	6.93	6.81	6.99	8.19	8.14
June	9.53	9.32	8.15	7.79	6.80	6.92	6.89	6.94	8.25	8.25
July	9.48	9.42*	8.09	7.76*	6.83	6.64*	6.95	6.69*	8.25	8.25*
August	9.50	9.36	8.10	7.68	6.85	6.30	7.02	6.37	8.25	8.25
September	9.42	9.14	8.01	7.46	6.79	6.24	7.05	6.30	8.25	8.11
October	9.34	9.08	7.89	7.36	6.75	6.19	7.01	6.26	8.25	8.00
November	9.29	9.16	7.80	7.47	6.70	6.28	6.92	6.34	8.25	8.00
December	9.25	9.27	7.75	7.56	6.67	6.43	6.90	6.51	8.25	8.00
January 1988	9.12	9.42	7.62	7.73	6.54	6.62	6.74	6.69	8.25	8.00
February	9.15	9.48	7.62	7.82	6.57	6.78	6.75	6.86	8.25	8.16
March	9.13	9.56	7.62	7.91	6.65	6.89	6.81	6.94	8.25	8.25
April	9.32	9.55	7.85	7.88	6.78	6.95	6.99	7.03	8.25	8.38
May	9.35	9.51	7.87	7.84	6.93	6.93	7.08	7.05	8.25	8.50
June	9.43	9.45	7.97	7.77	7.04	7.05	7.22	7.14	8.25	8.50

* Fore. = May Forecast

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* = This item and those beyond it are projections.



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MONTHLY PROJECTIONS August 1987

Dr. Donald Ratajczak, Director
For Release: September 9, 1987

WHAT SLUGGISH ECONOMY?

On the surface, August's employment report showed a continuation of a relatively moderate economy. Payroll employment increased only 155,000 while the manufacturing workweek remained unchanged. However, surface images sometimes are deceiving. Employment gains in July were more than 300,000, some of which may have been caused by seasonals that are no longer appropriately reflecting monthly employment patterns. In particular, the apparel and textile industries showed significant employment gains in July followed by employment weakness in August. However, if the July observations are completely ignored, a rising trend in employment prospects in manufacturing appears to be developing. In those industries, increased mechanization virtually has eliminated the old procedure of shutting down the mill in July for vacations. However, the seasonal factors still may be capturing some of that historical behavior. Therefore, activity was overstated in July before more normal behavior returned in August.

Also contributing to the employment weakness was a slight decline in retail employment and marginal employment changes in wholesale trade. Most of the time, a portion of the Labor Day weekend occurs in August. As a result, retailers are increasing their staffs by the time of the employment survey for August. This year, however, Labor Day is unusually late. Thus, the pickup in retail activity may not have materialized as early as expected. This would lead to understating employment gains in August before recapturing these gains in September.

Even with these seasonal distortions, the employment report was stronger than it appeared. The index of hours worked increased by 0.5% in August to 121.2. Hours worked almost certainly will grow more than 3% in the quarter. With little growth in distributive employment, where productivity performance has been especially poor in this cycle, and with a significant increase in the ratio of production to total workers in manufacturing, productivity gains are almost certain this quarter. Thus, the employment report suggests GNP growth

comfortably above 3% probably has developed for the third quarter. As economic activity expanded at nearly a 3.5% rate in the first half of this year, a portrait of a sluggish economy is not developing.

To be sure, some of the strength in economic activity is occurring in inventory rebuilding. Manufacturing inventories increased 0.4% in July and will be a significant contributor to third quarter economic activity. Retail inventories probably diminished as auto incentives once again swelled consumer activity by removing unwanted auto inventory from dealers' lots. Although the trade balances in July could be even worse than those in June, after adjusting for larger price changes for imports than exports, the real trade deficit continued to improve modestly. Only weakness in construction remains to support those looking for a sluggish economy.

To the extent that the consumer is now overextended and must eventually slow spending to more modest rates of income expansion and to the extent that inventory accumulations cannot continue to provide most of the impetus for an economic expansion, this spurt in activity is short-lived. Slower economic growth almost certainly will be forthcoming next year. However, those subsequent possibilities are not as significant in influencing interest rate pressures as current realities. Stronger economic activity has exerted upward pressures upon short-term interest rates.

Unfortunately, a reaccelerating economy at this stage in the business cycle may rapidly run into bottlenecks or longer term supply constraints. In some regions of the country, unemployment rates are hovering near 4%. Although wages are not yet booming in any region, these unusually low unemployment rates are beginning to exert wage pressures. Nationwide, the hourly earnings index increased 0.4% in August and now stands 2.6% above previous year levels. This is a definite increase from the 1.8% year-over-year performance that prevailed early this year. Thus, the beginning of labor market pressures may be apparent in the latest employment statistics.

As the Federal Reserve increased its discount rate in order to forestall inflationary developments, it is possible that these wage rate pressures were uppermost in their concerns. Certainly, other measures of near-term inflationary pressures are beginning to subside. The Journal of Commerce Index of sensitive material prices has averaged just slightly over .99 for the past month. This index peaked in excess of 100 during the spring. Other sensitive commodity prices, except the metals, appear to be down from their spring highs. Our estimates of the PPI for August show no change and the CEI could show a second consecutive 0.2% rate of increase. On the other hand, the dollar has been falling against other currencies, raising the specter of more inflationary pressures down the road.

Most likely, the Federal Reserve wanted to indicate that the Greenspan regime will be as concerned about inflation as the Volcker era. A discount rate increase was long overdue as federal funds rates were trading more than a percentage point above rates at the discount window. Moreover, current strength in the economy precluded any likelihood of reduced short-term interest rates in the months ahead. Thus, some realignment of the discount rate to other short-term interest rates had to be achieved. Moreover, the fed Chairman was going to travel to Basel to meet with other central bankers. Traveling after a discount rate hike would calm calls from his banking peers for more direct Federal Reserve action. Thus, all the factors were in place for the Federal Reserve to increase the discount rate and blame it on rising inflationary pressures.

Unfortunately, bank rates also rose with the increase in the discount rate. This will increase the cost of doing business and will also increase those consumer loans tied to floating rates. Therefore, the Federal Reserve action probably will slow economic activity early next year, especially in the interest-sensitive construction and consumer durables sectors. This increases the likelihood that the economic spurt that currently is developing could be followed by a substantially subdued economic environment sometime in 1988. Moreover, the discount rate still is well behind other short-term interest rates. Therefore, other discount rate increases should be anticipated in the weeks ahead.

Quarterly Profile of GNP

	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1988-2</u>	<u>1988-3</u>	<u>1987</u> <u>Annual</u>	<u>1988</u> <u>Annual</u>
Real:	2.3	3.7	1.9	3.3	3.0	2.0	2.6	2.7
Price:	3.8	3.7	4.6	4.0	3.9	4.9	3.3	4.3
Nominal:	6.6	7.5	6.6	7.4	7.0	7.0	6.0	7.0

Monthly Statistical Highlights for August 1987

Personal income +0.5%; savings rate 1.8%; personal consumption +1.5%; retail sales +3.0%; housing starts 0.0%; housing permits +1.1%; construction expenditures -0.1%; business inventories +0.3%; orders for durable goods -0.8%; orders for nondefense capital goods -5.2%; industrial production +0.4%; CPI +0.2%; PPI 0.0%; consumption deflator +0.2%; leading indicators +0.2%; real GNP (AR) +4.2%; M1 (AR) +7.1%; M2 (AR) +5.9%.

Monthly Statistical Highlights for September 1987

Payroll employment +245,000; index of hours worked +0.4%; household employment +262,000; civilian unemployment rate 6.0%; personal income +0.5%; savings rate 1.9%; personal consumption +0.3%; retail sales +0.2%; auto sales 12.0 million units; housing starts -1.5%; housing permits -2.1%; construction expenditures -0.0%; business inventories +0.2%; orders for durable goods -0.3%; orders for nondefense capital goods -1.5%; industrial production +0.2%; CPI +0.4%; PPI +0.2%; consumption deflator +0.3%; leading indicators -0.3%; real GNP (AR) +1.6%; M1 (AR) +6.2%; M2 (AR) +6.3%.

Commentary

Employment - As mentioned above, seasonal factors significantly distorted manufacturing and trade employment in August. Stronger employment gains in both sectors are expected in September. Despite relatively modest increases in payroll employment, increasing hours in the nonmanufacturing sector led to a

relatively strong boost in the index of hours worked. Some anecdotal evidence suggests that part-timers are being replaced by full-timers, leading to slower job growth but increased hours worked and more productive work units.

Next month, the household survey probably will reverse the June pattern, where the labor force was underestimated because of an unusually early survey. In September, a spurt in the labor force probably will develop that could cause a slight increase in the unemployment rate. However, strong growth in employment probably will prevent that from occurring. Nevertheless, a surge in the teenage unemployment rate probably should be anticipated at that time.

Personal Income and Outlays - A 0.8% increase in the hourly wage before adjustment for composition changes almost certainly will cause a significant spurt in wage and salary earnings. Also, the interest rate component should improve significantly. Farm incomes also should be rising. As a result, personal income should rebound in August. This will follow surprisingly weak wage and salary gains in July, when manufacturing earnings actually declined. The cause of this surprising weakness remains unclear. In addition, monthly personal income statistics continued to show a tendency to understate improvements in interest income. Apparently, tax liabilities will surge during all the quarterly estimating periods, as many taxpayers with significant capital gains income apparently are willing to continue to pay relatively high estimated taxes to prevent penalties for inappropriate estimation. After increasing significantly in June, tax liabilities basically flattened in July. More normal rates of gain are expected in August before another surge in liability develops in September. Because of these high estimated tax payments, the underpayment of taxes as a result of the W-4 withholding problem early in 1988 will be significantly mitigated.

A sharp increase in service expenditures in July appears to be involuntary as a result of unusually hot weather. The weather remained hot in August but should become more seasonal in September. If so, service expenditures should slow at that time. In addition, the stock market is no longer generating the same volume of activity as earlier. This will reduce the imputed financial services incorporated in the services expenditures component.

Retail Sales - Sales of hardware and furniture were substantially stronger than anticipated in July. Stronger sales growth probably will occur than contained in our forecast. However, as housing activity slows, these sales also are expected to slow early in 1988.

Automobile sales once again are responding to substantial incentives. The sales may be partially distorted as a result of the unusually late Labor Day period. As a result, the last ten days of August appeared to show a dramatic slowing in automobile sales. However, a pickup in sales may occur during the Labor Day week in early September. Other retail sales may also be impacted by this seasonal distortion. Later in the month, a reduction in incentive related cars should slow automobile sales. A plunge in sales then is anticipated in the fall before a return to more normal rates of growth develop early in 1988.

Construction - Although single-family starts rebounded in July, housing permits for single-family units were unusually weak. Apartment starts were weak but permits strengthened. As a result, apartment activity may stabilize near the 450,000 - 470,000 unit level for the remainder of this year. However, single-family units are expected to be adversely effected as mortgage interest rates

reach 11%. This insures a more sluggish housing market than originally anticipated. However, higher housing prices will lead to greater dollar values for residential construction than contained in the forecast. Only late in 1988 will the reduced units currently projected lead to greater sluggishness in residential construction expenditures.

Public construction has been surprisingly weak in the past few months following a surge in highway activity earlier in the year. Some of this weakness appears to be related to problems associated with the tax-exempt market. Many municipalities are reluctant to float tax-exempt bonds because of the anti-arbitrage rules that the treasury has imposed upon them. This appears to be having an adverse effect upon public construction activity and is expected to restrain that activity below our forecasted values. Nonresidential activity appears to be falling more rapidly than construction contracts suggest. Of course, weakness was anticipated as a result of changes in the tax codes. Nevertheless, the FW Dodge contract series shows no decline in contracts during the first half of 1987. Typically, this would mean that contract construction would not decline until six to nine months later. However, some of these contracts are not being utilized and construction is falling significantly. Weakness appears to be widespread in all sectors of construction with the exception of industrial activity.

Business Activity - Manufacturing orders spurted in July as a result of increased delivery delays. Further increases in manufacturing orders probably will develop through the remainder of this year. This is adding an area of strength to industrial activity that previously did not exist.

The spurt in orders for nondefense capital goods only partially reflects unusually large commercial aircraft orders. This commercial aircraft will not be delivered until the end of this decade, and, therefore, has little impact upon near-term capital spending activity. However, machinery is beginning to rebound as domestic producers once again are becoming competitive with foreign competition. Nondefense capital goods should show stronger gains than originally anticipated.

On the other hand, weakness in defense shipments during July is not easy to determine. Orders remain more than \$1 billion above shipments, suggesting that further growth in shipments should be forthcoming.

Seasonal problems associated with manufacturing employment also are distorting the industrial production series. Industrial production could increase at a much slower rate in the next two months than currently projected. It is noteworthy, however, that industrial production has spurted much more rapidly in the past few months than expected in our August forecast.

Prices - Oil prices appear to have peaked, although the rate of descent remains slow. Most oil product prices did not respond to the latest spurt in crude petroleum prices and, therefore, are not likely to fall significantly unless crude prices decline below \$18 per barrel. Current demand-supply conditions in world oil markets suggest that a temporary price plunge below \$18 is likely. However, a rebound above the \$18 level should develop before winter begins. Moreover, increasing world demand and reduced world supply should maintain prices above \$18 per barrel through 1988 and cause prices to gradually head higher in subsequent years.

Meat prices also have stabilized after a spring and early summer spurt. As a result, commodity prices are expected to grow at a relatively slow rate through much of the fall. An acceleration in commodity inflation then is anticipated in the winter and spring months. Nevertheless, inflation appears to be developing at a slower rate than expected in our August forecast. The only exception to this is the dramatic acceleration in the construction deflator. A sharp 0.7% gain in that deflator during July is not expected to persist, as it apparently was caused by a temporary tightening in lumber supply. As construction diminishes, however, the construction deflator should grow at much more moderate rates.

Miscellaneous - The leading indicators have been bolstered by continuing gains in the stock market and a spurt in the smoothed sensitive price series. Unfortunately, that sensitive prices series is very heavily weighted by the lumber component and should not be considered as a signal of early inflationary surges. In 1984, that measure of sensitive prices rose dramatically without being a harbinger of rising inflation. Moreover, those sensitive prices probably are beginning to diminish in intensity. Therefore, the leading indicators will have some difficulty moving further forward. Vendors' performance also has been adding to the indicators in the past few months but is unlikely to continue so dramatically. Even so, the indicators already are significantly above where they should have been relative to the variables forecast in our August analysis.

The trade balances are developing worse than expected only a month ago. Both the value and volume of oil is significantly adding to the imbalances. However, economic strength also is pulling in a lot of imports. This indicates that the trade balances will be much higher and require a greater adjustment in currency values than originally anticipated.

Financial Markets

Strengthening economic activity has placed upward pressures upon short-term interest rates. For this reason, it became apparent that the gap between the federal funds rate and the discount rate would not be closed by an easing of general short-term interest rates. Indeed, the current discount rate increase is not sufficient to eliminate the gap. Interest rate pressures are still intensifying as a result of increased inventory accumulations. In the latest reporting week, the commercial paper rate exceeded the federal funds rate by ten basis points. Such an increase usually suggests that credit market demand pressures are creating higher rates. Because of these increased pressures it is apparent that no dip in short-term interest rates is likely over the next year. Indeed, further increases in short-term interest rates could develop if inventory accumulations remain intense through the fourth quarter. Our current projections suggest that inventory accumulations will moderate at that time, however.

One other problem remains, as the discount rate still is too far below the federal funds rate. Thus, another increase in the discount rate in the near future, probably to defend the dollar's value, should be anticipated. If this discount rate move is merely for psychological purposes and does little to exert upward pressures on other short-term interest rates, there is no reason why the prime rate should move up further. However, banks may try to use a discount rate move to widen their spread. Therefore, a prime rate in excess of 9% may occur before year's end.

Long-term interest rates also are being pressed upward. The increase in these rates is more difficult to explain as near-term inflationary pressures are not intensifying. On the other hand, inflationary danger signals are beginning to develop. In particular, acceleration in the hourly earnings index must be viewed with some concern. Also, the dollar's weakness probably indicates more inflationary pressures into 1988. The credit markets are clearly anticipating intensified inflationary problems. Again, interest rates could rise further than currently being projected as these inflationary fears intensify. On the other hand, there is no evidence that the fears are supported by reality.

Our analysis by sector shows some reasons for rising interest rates but only very marginally. The government sector has been reducing its credit market pressures as deficits gradually have been diminishing. However, those deficits are expected to increase in the year ahead. The corporate sector is significantly increasing its use of funds as inventory activity increases and as capital spending also intensifies. However, internally generated funds are also growing rapidly. Therefore, the net position of the corporate sector probably will be relatively unchanged through much of the next year. The household sector has dramatically been reducing their contributions to the credit market. Savings rates have plunged with the increase in automobile sales. This reduced contribution to the credit markets may very well be a contributing factor to higher rates of interest. However, the major source of rising interest rates appears to be the increased reluctance of foreign investors to purchase financial assets in the United States. This reluctance is largely the result of a narrowing in the interest rate spread between yields in the United States and abroad. As these spreads narrowed, the attractiveness of American assets has been reduced. Thus, some widening of the spreads in the form of higher U.S. interest rates may be necessary before foreign investors again provide their normal share of contributions to our credit markets.

Equity Markets - Normally, rising short-term interest rates and a significant increase in long-term interest rates would be the death knell of a bull market. Ultimately, rising equity values will be coming to an end, as the combined facts of higher financing costs reducing the earnings potential of corporations and the reduced value of earnings associated with rising bond yields begins to discourage equity investors. Only obvious valuations, such as the improving capital goods, textile, and plastics industries or substantial development stories should justify investment at this time. Most investors should begin a defensive approach to their investment activities with the view that stock prices could fall in value as rapidly as bond prices have done in recent weeks.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	101598	101598	119.6	119.6	111835	111835	6.3	6.3	172.6	172.6
May	101672	101708	120.2	120.2	112447	112447	6.3	6.3	172.7	172.9
June	101788	101818	120.1	120.0	112257	112257	6.1	6.1	173.1	172.9
July	101973	102114	120.4	120.6	112462	112727	6.2	6.0	173.5	173.2
August	102150	102270	120.6	121.2	112653	113081	6.1	6.0	173.9	173.9
September	102327	102515*	120.9	121.7*	113171	113343*	6.2	6.0*	174.5	174.3*
October	102485	102701	120.9	121.9	113029	113406	6.3	5.9	174.7	174.6
November	102628	102889*	121.0	122.1	113292	113618	6.3	5.9	175.0	174.9
December	102771	103062	121.2	122.2	113556	113816	6.2	5.9	175.2	175.2
January 1988	102965	103247	121.4	122.5	113769	114036	6.2	5.8	175.8	175.6
February	103163	103425	121.7	122.7	113970	114247	6.2	5.8	176.6	176.0
March	103360	103603	122.1	122.9	114173	114484	6.1	5.7	177.4	176.5
April	103526	103784	122.2	123.1	114388	114706	6.2	5.7	177.8	177.1
May	103693	103956	122.4	123.2	114595	114909	6.2	5.6	178.3	177.8
June	103860	104142	122.5	123.4	114804	115105	6.1	5.6	178.9	178.5
July	104051	104327	122.7	123.6	114992	115325	6.1	5.6	179.5	179.2
August	104225	104516	123.0	123.8	115134	115538	6.0	5.5	180.1	179.8
September	104400	104706	123.3	124.0	115276	115770	6.1	5.5	180.7	180.5

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	3.700	3.704	2.182	2.182	32.9	42.3	3.067	3.070	3.034	3.028
May	3.718	3.713	2.193	2.194	146.4	136.7	3.176	3.171	3.030	3.035
June	3.731	3.723	2.201	2.200	122.3	102.9	3.173	3.165	3.050	3.062
July	3.749	3.738	2.211	2.205	122.8	88.9	3.190	3.177	3.067	3.088
August	3.765	3.756*	2.220	2.216*	119.5	57.4*	3.204	3.191*	3.085	3.134*
September	3.782	3.773	2.228	2.226	99.3	59.5	3.220	3.203	3.121	3.144
October	3.795	3.793	2.236	2.238	111.2	116.8	3.229	3.219	3.118	3.102
November	3.809	3.810	2.244	2.248	105.0	102.7	3.238	3.231	3.133	3.128
December	3.825	3.826	2.252	2.256	100.8	88.3	3.249	3.243	3.148	3.155
January 1988	3.834	3.839	2.265	2.266	128.7	110.3	3.296	3.283	3.167	3.173
February	3.855	3.858	2.277	2.279	124.9	120.4	3.308	3.305	3.183	3.185
March	3.886	3.875	2.290	2.290	111.7	116.3	3.315	3.319	3.203	3.203
April	3.907	3.897	2.301	2.304	117.3	120.0	3.346	3.337	3.219	3.217
May	3.919	3.918	2.313	2.316	121.3	117.8	3.353	3.354	3.232	3.236
June	3.931	3.941	2.325	2.331	122.7	123.5	3.370	3.373	3.247	3.250
July	3.955	3.962	2.337	2.345	120.1	123.8	3.383	3.389	3.263	3.265
August	3.978	3.984	2.349	2.359	112.8	124.3	3.397	3.406	3.284	3.282
September	4.001	4.006	2.361	2.373	109.2	121.8	3.411	3.423	3.302	3.301

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	2939.7	2933.8	411.6	408.1	979.3	976.8	1548.8	1548.9	2497.0	2488.1
May	2935.9	2940.6	403.8	402.3	977.3	983.4	1554.7	1555.0	2481.2	2482.1
June	2956.3	2967.5	413.6	412.1	974.4	986.8	1568.3	1568.6	2487.9	2496.8
July	2973.2	2993.1	414.3	418.0	979.5	992.0	1579.4	1583.1	2492.2	2511.7*
August	2990.1	3038.4*	412.8	449.5*	988.3	996.3*	1589.0	1592.6*	2498.0	2546.2
September	3025.9	3047.9	429.6	446.6	997.7	1000.8	1598.6	1600.5	2521.6	2546.2
October	3022.6	3006.2	415.5	390.9	1000.6	1005.6	1606.5	1609.7	2510.5	2496.5
November	3037.5	3031.8	419.4	403.8	1002.6	1009.5	1615.5	1618.5	2516.6	2511.5
December	3052.4	3057.7	423.4	416.6	1004.7	1013.8	1624.3	1627.3	2522.6	2526.3
January 1988	3071.3	3075.4	425.8	420.2	1010.6	1018.4	1634.9	1636.8	2527.8	2532.3
February	3087.0	3087.0	422.7	419.1	1018.9	1022.0	1645.4	1645.9	2532.4	2534.5
March	3107.3	3104.7	424.4	422.0	1026.9	1026.5	1656.0	1656.2	2538.0	2540.0
April	3122.3	3118.6	427.1	424.0	1030.4	1031.5	1664.8	1663.1	2540.5	2543.8
May	3135.0	3137.4	427.5	427.4	1033.6	1037.1	1673.9	1672.9	2542.6	2551.7
June	3152.8	3150.3	433.0	427.2	1036.8	1041.7	1683.0	1681.4	2548.7	2551.8
July	3170.9	3165.6	438.8	426.3	1042.5	1047.1	1694.6	1692.2	2553.1	2553.9
August	3186.7	3181.7	432.5	427.0	1048.3	1051.3	1705.9	1703.4	2555.5	2556.0
September	3204.0	3200.8	432.7	428.9	1054.1	1056.6	1717.2	1715.3	2561.2	2561.6

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	124.96	124.96	20.03	20.03	10.4	10.5	76.83	76.83	28.10	28.10
May	124.55	124.87	20.07	20.00	9.7	9.9	76.86	77.08	27.61	27.78
June	125.08	126.62	19.98	20.05	10.2	10.2	76.97	77.54	28.13	29.04
July	125.60	127.57	20.30	20.15	10.2	10.5	77.08	77.82	28.22	29.60
August	126.12	131.40*	20.19	20.26*	10.1	12.3*	77.78	78.16*	28.15	32.98*
September	128.83	131.66	20.07	20.30	11.0	12.0	78.52	78.51	30.24	32.85
October	127.33	125.41	20.27	20.37	9.6	8.9	79.17	78.89	27.89	26.15
November	128.01	127.25	20.34	20.44	10.0	9.4	78.90	79.19	28.77	27.62
December	129.15	129.11	20.02	20.50	10.5	10.0	79.07	79.53	30.06	29.08
January 1988	129.39	129.90	20.02	20.58	10.4	10.2	79.53	79.82	29.84	29.43
February	129.68	130.05	19.94	20.61	10.2	10.1	80.18	80.17	29.56	29.77
March	130.51	130.76	19.97	20.68	10.3	10.2	80.81	80.53	29.73	29.55
April	131.10	131.38	20.09	20.73	10.4	10.3	81.09	80.92	29.92	29.73
May	131.40	132.23	20.08	20.79	10.4	10.5	81.34	81.36	29.98	30.08
June	132.30	132.57	20.52	20.70	10.5	10.5	81.59	81.72	30.19	30.15
July	132.84	132.88	20.75	20.72	10.4	10.4	82.04	81.14	30.05	30.02
August	133.15	133.29	20.69	20.75	10.3	10.4	82.50	82.47	29.96	30.07
September	133.62	133.94	20.65	20.79	10.3	10.5	82.95	82.89	30.02	30.26

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	1.686	1.643	1.238	1.208	1.586	1.598	397.3	397.1	349.2	349.1
May	1.598	1.606	1.115	1.130	1.487	1.493	398.6	394.3	349.6	345.9
June	1.552	1.597	1.067	1.096	1.469	1.517	394.0	392.4	345.0	342.7
July	1.588	1.611	1.103	1.159	1.503	1.488	391.9	391.8	342.0	339.9
August	1.611	1.611*	1.122	1.136*	1.516	1.505*	393.5	391.5*	341.9	338.1*
September	1.620	1.587	1.126	1.115	1.528	1.473	395.6	391.4	342.5	336.5
October	1.618	1.551	1.134	1.085	1.511	1.456	395.2	392.3	341.8	336.2
November	1.629	1.550	1.143	1.083	1.515	1.429	395.2	391.4	340.4	334.0
December	1.621	1.571	1.130	1.095	1.501	1.455	394.8	389.8	338.9	330.9
January 1988	1.583	1.605	1.108	1.126	1.492	1.489	396.9	390.6	339.8	329.9
February	1.560	1.603	1.083	1.120	1.467	1.506	399.0	392.8	340.7	330.4
March	1.552	1.579	1.086	1.092	1.473	1.501	401.3	395.7	341.5	331.1
April	1.588	1.558	1.115	1.085	1.489	1.467	401.9	396.7	341.2	330.9
May	1.609	1.565	1.139	1.093	1.521	1.465	403.4	396.1	341.6	329.3
June	1.608	1.574	1.130	1.098	1.518	1.473	404.9	396.7	341.7	328.4
July	1.589	1.588	1.116	1.105	1.493	1.479	409.4	397.8	344.3	328.2
August	1.595	1.574	1.102	1.082	1.498	1.483	412.0	399.5	345.3	328.3
September	1.592	1.568	1.104	1.076	1.492	1.480	414.1	400.7	346.2	328.2

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	121.4	121.3	76.7	76.3	199.2	199.5
May	123.8	126.6	75.8	74.6	198.9	193.1
June	123.0	121.7	76.1	72.2	194.9	198.3
July	122.3	120.4	77.0	73.2	192.6	198.2
August	122.0	119.6*	77.8	74.0*	193.7	197.9*
September	122.0	119.0	78.7	74.6	194.9	197.8
October	121.7	119.5	78.0	75.3	195.5	197.5
November	121.4	119.1	77.6	75.8	196.0	196.5
December	121.1	118.4	77.5	75.9	196.2	195.5
January 1988	121.4	118.3	78.8	76.5	196.7	195.8
February	121.6	118.5	80.1	77.1	197.3	197.2
March	121.9	118.8	81.5	77.6	197.9	199.3
April	122.5	119.4	80.7	78.1	198.7	199.2
May	122.8	119.7	81.1	78.5	199.5	197.9
June	123.2	120.0	81.5	79.0	200.2	197.7
July	123.8	120.3	81.9	79.4	203.7	198.1
August	124.4	120.0	82.1	79.9	205.5	199.6
September	125.1	120.2	82.4	80.4	206.6	200.1

fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	320.8	320.8	106.93	106.98	28.30	28.31	27.33	27.32
May	321.5	321.8	106.98	106.99	29.99	30.03	26.95	26.97
June	321.4	321.6	108.53	109.18	29.09	29.99	27.61	27.85
July	321.9	323.0	109.24	108.51	29.93	31.52	27.53	28.08
August	322.5	324.2*	107.65	107.59*	28.65	29.87*	27.65	28.23*
September	322.9	325.1	105.46	107.26	27.84	29.42	27.79	28.35
October	323.6	325.8	105.93	107.45	27.95	29.63	27.85	28.51
November	324.3	326.5	106.81	108.11	28.13	29.69	27.96	28.60
December	324.8	327.4	107.16	108.82	28.42	29.84	28.31	28.89
January 1988	325.3	328.0	107.03	106.76	28.06	28.17	27.46	27.96
February	326.0	328.9	107.42	107.16	28.31	28.29	27.83	28.25
March	326.9	329.8	107.95	107.85	28.59	28.53	28.21	28.43
April	328.1	330.6	106.64	107.92	28.47	28.50	28.25	28.40
May	329.0	331.5	106.93	107.27	28.53	28.46	28.33	28.67
June	329.3	332.3	107.72	107.65	28.69	28.55	28.24	28.62
July	330.0	333.1	107.59	109.43	28.75	29.11	28.43	28.75
August	331.4	333.8	108.86	109.96	28.89	29.38	28.55	28.81
September	331.8	334.7	109.43	109.47	29.06	29.30	28.72	28.80

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	665.9	665.9	8.76	8.76	127.3	127.4	79.4	79.5
May	670.4	671.6	9.23	9.24	128.0	128.3	79.7	79.9
June	669.2	674.2	9.36	9.44	128.2	128.8	79.7	80.1
July	673.4	677.5*	9.45	8.87	128.7	129.8	79.9	80.5
August	677.5	679.2	9.36	9.24*	129.0	130.3*	80.0	80.7*
September	678.1	680.6	9.40	9.33	129.3	130.6	80.0	80.8
October	682.5	682.4	9.46	9.30	129.6	130.8	80.1	80.8
November	685.3	684.3	9.55	9.42	129.8	131.1	80.1	80.9
December	687.4	686.9	9.63	9.48	130.1	131.3	80.1	80.9
January 1988	691.5	690.4	9.69	9.55	130.4	131.6	80.1	80.9
February	694.3	693.3	9.76	9.62	130.9	131.9	80.3	81.0
March	696.1	696.2	9.77	9.56	131.3	132.2	80.4	81.0
April	699.2	698.9	9.83	9.64	131.6	132.5	80.4	81.0
May	702.5	701.8	9.89	9.70	132.0	132.8	80.5	81.1
June	704.6	704.5	9.95	9.76	132.4	133.1	80.6	81.1
July	707.8	707.2	10.03	9.93	132.8	133.5	80.7	81.2
August	709.6	709.7	10.09	9.78	133.2	133.8	80.9	81.3
September	712.9	712.6	10.15	9.96	133.6	134.0	81.0	81.3

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations*

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	337.9	337.9	295.3	295.3	317.4	317.4	116.9	116.8
May	339.0	339.0	296.2	296.2	318.6	318.6	117.2	117.2
June	340.4	340.4	296.8	296.8	320.2	320.2	117.6	117.6
July	341.2	341.1	296.7	297.4	321.8	322.6	118.0	118.0
August	342.5	342.0*	297.3	297.3*	322.6	323.2*	118.4	118.2*
September	343.8	343.3	298.0	298.0	321.0	321.4	118.8	118.6
October	344.6	344.9	298.5	298.8	323.1	323.5	119.0	119.2
November	345.5	345.7	299.1	299.3	323.6	323.9	119.3	119.6
December	346.4	346.5	299.5	299.9	324.2	324.8	119.6	120.0
January 1988	347.6	347.3	300.1	300.6	325.8	325.7	120.0	120.4
February	348.7	348.6	300.6	301.3	327.6	327.2	120.5	120.7
March	349.9	349.9	301.2	302.2	329.3	328.5	120.9	121.2
April	351.4	351.3	302.5	303.2	330.5	329.7	121.3	121.5
May	353.0	352.6	303.8	304.3	331.0	331.0	121.7	121.9
June	354.6	354.0	304.1	305.0	331.5	331.8	122.1	122.4
July	356.0	355.5	305.5	306.1	333.9	332.9	122.5	122.9
August	357.1	356.9	305.8	306.9	335.0	334.2	123.0	123.4
September	358.3	358.3	306.3	307.8	333.7	335.5	123.4	123.9

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	117.7	117.9	106.0	105.9	111.1	111.2	126.2	126.5	113.8	113.8
May	118.3	118.5	105.9	105.9	111.8	111.8	126.8	127.2	114.0	114.0
June	118.8	118.9	106.2	106.5	112.4	112.3	127.3	127.4	114.2	114.5
July	119.3	119.2*	106.6	106.7*	112.8	112.7*	127.8	127.7*	114.6	115.3
August	119.7	119.3	107.0	106.5	113.2	113.1	128.2	128.1	115.1	115.8*
September	120.0	119.7	107.3	106.8	113.5	113.4	128.6	128.5	115.5	116.3
October	120.4	120.4	107.3	107.1	113.8	113.8	129.0	129.0	115.8	116.7
November	120.7	120.7	107.4	107.4	114.1	114.1	129.5	129.4	116.1	117.2
December	121.0	121.1	107.5	107.6	114.4	114.5	130.0	129.9	116.5	117.8
January 1988	121.5	121.4	107.8	107.8	114.8	114.9	130.5	130.3	116.8	118.4
February	121.9	121.8	108.0	108.0	115.1	115.2	131.0	130.7	117.1	118.9
March	122.4	122.2	108.2	108.3	115.4	115.6	131.5	131.2	117.5	119.5
April	122.9	122.6	108.5	108.5	115.9	116.0	132.0	131.6	117.8	119.9
May	123.3	123.0	108.8	108.8	116.4	116.3	132.6	132.1	118.1	120.3
June	123.7	123.5	109.1	109.0	116.8	116.8	133.2	132.6	118.5	120.8
July	124.2	124.0	109.4	109.3	117.3	117.2	133.8	133.2	118.9	121.2
August	124.7	124.5	109.6	109.5	117.8	117.7	134.3	133.8	119.3	121.7
September	125.1	125.0	109.9	109.8	118.2	118.1	134.7	134.4	119.6	122.1

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	fore	C.E.
April 1987	-13.32	-13.32	186.6	187.9	4420	4414	3781	3779	-15.9	-9.7
May	-14.40	-14.04	187.5	188.9	4452	4454	3799	3800	-20.3	-11.6
June	-14.00	-15.71	188.0	190.8	4474	4475	3804	3805	-22.9	-12.3
July	-14.63	-15.87p	188.6	191.8	4502	4505	3815	3818	-16.3	-10.5
August	-14.27	-14.86*	188.9	192.2*	4524	4528*	3821	3831*	-10.5	-7.3*
September	-13.60	-14.55	189.4	191.7	4546	4550	3827	3836	-7.4	-5.4
October	-12.96	-13.29	189.0	192.0	4563	4573	3834	3836	-9.5	-6.6
November	-13.55	-14.42	188.6	192.4	4575	4596	3835	3843	-13.4	-8.9
December	-13.73	-14.57	189.1	192.8	4594	4633	3841	3861	-15.5	-11.5
January 1988	-13.26	-14.26	188.7	191.6	4622	4656	3852	3867	-16.2	-10.2
February	-12.43	-13.53	188.2	192.1	4657	4682	3865	3879	-17.1	-11.5
March	-11.86	-13.05	187.8	192.5	4680	4711	3871	3887	-17.1	-11.8
April	-12.24	-13.16	187.2	192.2	4701	4735	3876	3897	-16.3	-12.5
May	-12.85	-13.52	188.0	192.0	4735	4761	3891	3906	-15.4	-12.1
June	-12.76	-13.81	188.3	192.3	4771	4794	3907	3917	-14.5	-12.4
July	-13.56	-13.96	188.9	192.9	4795	4818	3914	3920	-13.9	-13.1
August	-13.02	-13.65	189.2	193.3	4816	4843	3915	3925	-13.2	-13.8
September	-11.90	-12.47	189.3	193.0	4838	4874	3921	3934	-13.5	-13.5

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	262.2	262.2	750.4	750.3	2839.1	2837.9	6.37	6.37	5.90	5.90
May	263.4	263.4	753.2	753.1	2840.1	2838.7	6.85	6.85	6.05	6.05
June	263.8	263.4	746.7	746.6	2842.8	2840.3	6.73	6.73	5.99	5.99
July	264.4	264.3	748.5	747.6	2854.3	2846.0	6.56	6.58	5.88	5.76
August	265.5	266.3*	750.6	751.9*	2868.1	2859.6*	6.65	6.72*	5.80	6.13*
September	266.7	267.5	752.9	755.7	2881.8	2874.1	6.68	6.96	5.83	6.29
October	268.9	268.8	758.4	758.0	2898.3	2885.6	6.73	7.05	5.86	6.43
November	270.8	269.6	763.1	760.8	2913.6	2899.2	6.70	6.93	5.93	6.40
December	272.6	270.9	767.9	765.3	2925.7	2916.3	6.59	6.95	6.02	6.42
January 1988	274.5	272.4	773.5	770.6	2948.2	2936.5	6.43	7.06	5.79	6.55
February	276.4	274.3	779.4	776.5	2967.5	2954.9	6.34	7.13	5.70	6.62
March	278.3	276.5	785.5	783.3	2986.6	2978.8	6.25	7.12	5.65	6.65
April	280.0	278.0	790.3	786.7	3003.5	2991.7	6.38	6.98	5.88	6.58
May	281.7	279.8	796.1	789.0	3020.2	3003.7	6.69	6.93	6.01	6.53
June	283.4	281.4	801.8	794.1	3036.9	3023.1	6.94	7.02	6.13	6.59
July	285.1	283.3	805.2	800.3	3054.5	3043.7	6.73	7.16	6.08	6.69
August	286.8	285.1	809.1	805.7	3072.4	3064.2	6.56	7.26	5.93	6.84
September	288.5	287.0	813.0	811.9	3090.1	3084.7	6.57	7.34	5.80	6.89

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	8.85	8.85	7.55	7.55	6.45	6.45	6.52	6.52	7.75	7.75
May	9.33	9.33	8.00	8.00	6.93	6.93	6.99	6.99	8.14	8.14
June	9.32	9.32	7.79	7.79	6.92	6.92	6.94	6.94	8.25	8.25
July	9.42	9.42	7.68	7.72	6.67	6.65	6.75	6.70	8.25	8.25
August	9.50	9.63*	7.74	7.80*	6.65	6.67*	6.73	6.73*	8.25	8.25*
September	9.50	10.06	7.70	7.94	6.73	6.93	6.84	7.00	8.25	8.72
October	9.59	10.23	7.82	8.08	6.78	7.02	6.89	7.08	8.25	8.75
November	9.57	10.02	7.77	7.92	6.75	6.95	6.83	7.05	8.25	8.75
December	9.54	10.07	7.73	7.97	6.55	6.92	6.67	7.01	8.25	8.75
January 1988	9.33	10.18	7.52	8.08	6.40	7.02	6.53	7.13	8.25	8.75
February	9.18	10.05	7.34	7.95	6.26	7.18	6.39	7.22	8.25	8.75
March	9.21	10.02	7.37	7.92	6.25	7.15	6.35	7.24	8.25	8.75
April	9.37	10.12	7.54	7.94	6.41	7.04	6.52	7.15	8.25	8.75
May	9.48	10.15	7.64	8.06	6.68	6.92	6.79	7.04	8.25	8.75
June	9.59	10.20	7.75	8.11	6.95	7.01	7.06	7.09	8.25	8.75
July	9.33	10.34	7.48	8.27	6.76	7.26	6.89	7.34	8.25	8.75
August	9.21	10.59	7.37	8.53	6.53	7.42	6.65	7.51	8.25	8.92
September	9.09	10.68	7.24	8.63	6.50	7.51	6.63	7.60	8.25	9.00

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.



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MONTHLY PROJECTIONS September 1987

Dr. Donald Ratajczak, Director
For Release: September 25, 1987

THE LAST PHASE OF THIS EXPANSION

This unusually long economic expansion has been aided by the 1986 collapse in oil prices and an earlier premature tightening move by the Federal Reserve in 1984. The 1984 Federal Reserve action caused an unusually overvalued dollar that sapped the strength of industrial America at a time when consumers still were willing and able to pursue a buying binge. When consumer debt had risen to levels that normally create restraint, the 1986 oil price collapse put even more purchasing power in their pockets. At the same time, an overvalued dollar caused manufacturing to increase efficiencies and maintain tight controls on production relative to sales. Only the automobile industry showed any deviation from good production and sales coordination. With consumption continuing to expand but with industrial activity corralled by foreign competition, a slow growth economy showed no prospects of readily creating industrial bottlenecks or exhausting the available pool of skilled workers.

Skilled workers still are plentiful, although the insured unemployment rate has now reached a low for this cycle at 2.2% in the week of September 5. Some studies suggest that an insured unemployment rate approaching 1.5% is consistent with full employment for the national economy. Thus, the pool of available experienced workers is shrinking but should not hit those full employment limits in the next few months.

On the other hand, labor force growth has slowed sharply even as economic activity appears to be intensifying. Teenage participation rates remain stuck at 56% while the teenage population slowly drifts downward. Participation rates for males over twenty also appears to be stuck at 78% despite falling unemployment rates. Only the participation rates of females are rising, and their rate of increase appears to be only half as rapid as earlier in the decade. Because of these changes in labor force activity, this year's labor force is growing 0.3 percentage points more slowly than last year despite significant gains in employment opportunities. Indeed, excluding the effects of

changing unemployment upon labor force participation, the full employment labor force probably is growing only 1.5% per year.

This slower labor force growth would reduce unemployment even if economic activity continued to grow at subdued rates. However, industrial activity is spurting forward at a 4% annual rate, as measured by the industrial production index. Total economic activity may be growing at a 3.5% annual rate. With productivity improving less than 1% for the overall economy, and the workweek near cyclical highs, the unemployment rate is now plunging at nearly a percentage point per year. As a result, some of the low unemployment regions of the country along the Atlantic Ocean are experiencing difficulties in attracting entry-level workers. Wages are beginning to intensify, especially in the service industries.

This pattern of tightening labor markets and increasing wage pressures has been experienced many times before, in the final phases of an economic expansion. Normally, labor shortages are more closely aligned with capacity problems and the effects of increasing activity upon economic costs are more abrupt than currently being observed. Indeed, the hourly earnings index remains only 2.6% above previous year levels, although the August report showed a spurt of 4.8% at annual rates. The index measuring delivery delays is only 62 as opposed to a rating in the 70s prior to most economic peaks. However, that index has risen by a full 10 percentage points in the past three months. Also, while capacity utilization remains a relatively low 81%, utilization rates exceed 97% for the textile and paper industries and are also above 90% for rubber and plastics. In addition, utilization rates in the metals-producing industries have increased by more than 7 percentage points in a year. While ample excess capacity remains, this capacity is not available at a moment's notice. Furnaces need to be lined and primed before metal production can begin. As a result, demand must appear to be strong for months into the future before additional capacity will be utilized. In short, the developing cost pressures associated with accelerating economic growth shows all the signs of the last stage of an economic expansion.

Economic activity can expand briskly for a period of time near the end of the expansion. This occurs as increased delivery delays intensify the demand for inventories. As a result, orders spurt upward for a period of time, hirings increase, the unemployment rate moves toward inflation-prone levels and economic activity can accelerate. However, also occurring are rising wage pressures, higher interest rates, especially short-term rates, and intensifying inflationary pressures. Some of the inflation may be experienced in commodities, but as wage pressures intensify, a significant amount of the inflationary pressures begin to spill over into services. That is exactly the pattern that appears to be developing, if in modified form.

Indeed, wages increased sufficiently in August to cause a 0.9% increase in real earnings despite a 0.5% gain in the CPI. Some of these wage gains were the result of composition changes, but hourly labor costs definitely are intensifying. Short-term interest rates are rising with commercial paper rates consistently above the federal funds rate. This normally is a signal of increasing borrowing pressures for inventory investing purposes. Service inflation, which had been well-contained through the first half of 1987, is beginning to intensify. There will be one more period of moderate inflation when oil prices decline late this year. As a result, this ending phase of the cycle will be elongated slightly, and may propel increasing economic activity through 1988.

Because economic friction begins increasing near the end of an economic upturn, interest rates also tend to rise along with inflation. Stock prices eventually will decline. However, both revenues and costs tend to rise. To the extent that revenues increase first, earnings may perform better than anticipated for a period of time. As a result, equity values could continue to rise. However, increased interest costs and rising wage cost pressures eventually will overcome the growth in revenues. Ultimately, earnings decline and equity values fall. When that occurs, the economy normally will be approaching a cyclical peak.

At the present time, the stock market is being buffeted between higher interest rates and favorable earnings performances. Because of reductions in marginal tax rates, corporate earnings in the third and fourth quarters should compare especially favorably with the previous year. For that reason, the stock market may not peak until the end of this year. However, downward pressures upon earnings could begin as early as the beginning of 1988. By that time, this unusually long bull market should come to an end.

Quarterly Profile of GNP

	<u>1987-2</u>	<u>1987-3</u>	<u>1987-4</u>	<u>1988-1</u>	<u>1988-2</u>	<u>1988-3</u>	<u>1987</u> <u>Annual</u>	<u>1988</u> <u>Annual</u>
Real:	2.5	3.7	2.5	2.9	2.4	2.2	2.7	2.7
Price:	3.5	3.2	4.4	4.1	4.1	4.6	3.1	4.1
Nominal:	6.3	6.9	7.0	7.1	6.7	6.9	5.9	6.9

Monthly Statistical Highlights for September 1987

Payroll employment +237,000; index of hours worked +0.3%; household employment +350,000; civilian unemployment rate 6.0%; personal income +0.5%; savings rate 2.0%; personal consumption +0.3%; retail sales +0.3%; auto sales 11.2 million units; housing starts -0.9%; housing permits -2.2%; construction expenditures UNC; business inventories +0.1%; orders for durable goods +1.1%; orders for nondefense capital goods +0.5%; industrial production +0.3%; CPI +0.4%; PPI +0.4%; consumption deflator +0.3%; leading indicator -0.3%; real GNP (AR) +2.9%; M1 (AR) +2.9%; M2 (AR) +4.4%.

Monthly Statistical Highlights for October 1987

Payroll employment +267,000; index of hours worked +0.3%; household employment +208,000; civilian unemployment rate 6.0%; personal income +0.6%; savings rate 3.2%; personal consumption -0.6%; retail sales -2.6%; auto sales 8.9 million units; housing starts -1.5%; housing permits -1.8%; construction expenditures +0.1%; business inventories +0.4%; orders for durable goods +0.8%; orders for nondefense capital goods +0.9%; industrial production +0.2%; CPI +0.3%; PPI +0.3%; consumption deflator +0.5%; leading indicator -0.3%; real GNP (AR) +0.9%; M1 (AR) +10.5%; M2 (AR) +7.4%.

Commentary

Employment - In the week ending September 12 insured unemployment plunged by 57,000 to a cyclical low of 260,000. A week earlier, the insured unemployment rate fell to 2.2%, also the lowest of this cycle. This data may be distorted by Labor Day seasonal problems, but the dimensions of the decline suggest that employment activity is more robust early in September than had been anticipated. No adjustments have yet been made to our projections to suggest more substantial economic activity, however.

Clearly, the speed by which insured unemployment is declining suggests that increasing wage pressures could develop soon after 1988 begins. The Ford-UAW contract already appears to add 20% to labor costs in the next three years, assuming a 5% rate of inflation. Such an increase, if practiced nationwide, would definitely add to inflation.

Personal Income and Outlays - Wage and salary earnings grew 0.9% in August, as anticipated; but farm income took an unexpected decline. Apparently, subsidy programs diminished sharply during the summer. Further modest decreases in farm incomes are expected in September. Because September tax liabilities coincide with estimated tax payments, a surge in those liabilities is anticipated. As a result, disposable income probably will increase by less than 0.5%.

Although automobile sales are slowing from their August surge, sales will remain relatively robust. Also, unusually hot weather that lasted through August and pushed up service expenditures, now is moderating. Therefore, service expenditures should show very minimal gains at that time. In addition, expenditures for durable goods reflected the magnitude of automobile unit sales in August, although the preliminary retail sales report sharply understated growth in auto revenues. As a result, retail sales probably will be revised upward significantly for August when the September data are announced. Because unit auto sales are declining in September, expenditures for durables should fall.

Following strong gains in July, sales of hardware and furniture fell significantly in August. As a result, sales of nonauto durable goods probably will grow much more slowly than originally anticipated.

Construction - Rising mortgage rates are beginning to effect housing starts. Single-family starts fell significantly in August, although housing permits suggest that a slight rebound is possible in September. Multi-family permits fell while multi-family starts rose in August. However, further weakness is expected for multiple units. Because mortgage rates are expected to approach 12% by the summer of 1988, single-family starts are expected to fall about 100,000 short of forecasted values. This means that housing starts will average slightly less than 1.5 million for 1988. Because of an acceleration in housing prices, residential construction expenditures are growing more rapidly than anticipated in our forecast. However, as starts begin declining significantly, construction expenditures will dip substantially below forecasted values. On the other hand, only a modest further decline in construction expenditures is anticipated.

Business Activity - Orders for nondefense capital goods fell sharply in August after climbing heights that had previously not been anticipated. As unfilled

orders continue to increase, this decline in capital goods orders is not serious. Indeed, capital shipments should continue to rise significantly, except for the year-end distortions that momentarily accelerate shipments late in the year and then cause weakness early in the subsequent year.

On the other hand, defense shipments are surprisingly weak and defense orders are continuing to slow. Even here, the backlog has not diminished, but it is not growing either. As a result, the growth in defense shipments is expected to be much more modest than originally expected. This is the result of previously enacted budgetary restraints. Although the August pause in durable goods orders is no cause for alarm, any further declines in orders during September could be viewed with some concern.

Business inventories were surprisingly brisk in July considering significant slowing in the growth of automobile inventories. Auto incentives should cause auto inventories to fall significantly in August and September. However, manufacturing inventories are expected to continue growing, but not at the substantial rate of July.

Although industrial production slowed to only a 0.3% rate of increase in August, the report was generally strong. Activity in plant and equipment increased by a full percentage point. While consumer goods production only increased 0.2%, this overcame a drop in auto assemblies from 6.7 million units to only 5.9 million units. Obviously, a rebound should be anticipated in the months ahead barring any auto strike. Certainly, moderate increases in industrial production appear likely in the next few months. In fact, a significant decline in initial unemployment claims may suggest that industrial activity is expanding more rapidly in September than currently projected.

Because of unusually low additions to capital at the present time, this moderate increase in industrial activity is leading to a significant increase in capacity utilization. By the middle of 1988, the utilization rates will exceed the highs previously reached for this cycle in 1984. When utilization rates cross 82%, orders normally are stimulated, unless the credit markets or financial conditions significantly dissuade investors.

Prices - Although the 0.5% increase in the consumer price index for August was a surprise, much of the higher performance than anticipated was the result of rising rental rates. Following a 0.6% increase in rents in July, which we assumed was the result of a new fiscal year, rents rose another 0.8% in August. Although the August increase probably will not be sustained in the next few months, reduced vacancy rates along with the absence of tax incentives for constructing apartment units is beginning to exert upward pressures upon rental rates. For the remainder of this year and well into next year, rents are expected to grow at a 6% annual rate. Previously, they were expanding at a 4% annual rate. Also, while many economists have argued that the August 0.5% increase is an aberration, several unsustainable pricing events kept that increase from being even higher. Auto financing incentives were introduced in August this year, while the seasonals were anticipating incentives a month from now. Light truck incentives will arrive in September. The auto industry wants to establish a 4% price increase for new model cars. Thus, the automobile and auto financing component will be adding to inflationary pressures in September and October. Also, grocery store prices fell in August. Our PPI estimates for September show that they will be up about a half percent. To be sure, gasoline prices, which surged 3.1% in August will show no growth in September. However,

it is clear that inflation is now running closer to 5% with the acceleration of some of the service components than to the 4% level that many economists thought would re-appear after oil prices stabilized.

Price increases for the producer price index in September reflect fewer additional auto incentives than normal because incentives for passenger cars began a month early. Also, unseasonal increases in food prices and continuing widespread increases in the metals prices are adding to price pressures. The chemicals, paper, and metals industries all have announced significant price increases for early October. Fortunately, crude material prices are no longer rebounding as dramatically as earlier in the year. Nevertheless, these price surges will continue to put upward pressures upon commodity inflation into the early months of 1988. It is simply inappropriate for Alan Greenspan to declare that no signs of inflationary pressures exist at the present time.

Miscellaneous - Stock prices continued to rise in August. In addition, sensitive prices may have added slightly to the leading indicators. Delivery delays appear to be as intense in August as they were in July. Furthermore, insured unemployment claims are now falling significantly. By September, however, stock prices may subtract from the leading indicators. In addition, sensitive prices almost certainly will be reversing contributions from positive to negative. Therefore, a temporary lull in growth of the leading indicators is anticipated.

On the other hand, the merchandise trade balance in August should improve considerably from the record deficit in July. Seasonal factors will be aiding manufacturing exports. Also, significant exports of American grains occurred in recent weeks. On the other hand, oil imports appear to be slowing following their July surge. Thus, the merchandise trade balance should improve by nearly \$2 billion from the previous month.

FINANCIAL MARKETS

As economic activity continues to surge during the summer months, interest rate pressures continue to intensify. Loan activity does not show the magnitude of interest rate as many corporations are self-financing their inventory expansion. However, this diminishes the responsiveness of corporate treasurers to bank sales of short-term certificates. This explains why interest rates for C.D.s are rising sharply early in September.

The one good news in the interest rate profile is the reduction in government deficits. It now appears that the 1987 deficit was under \$160 billion. Of course, some of that improvement was the result of one-time payments for large capital gains transactions. Some increase in the deficit should be anticipated for the next fiscal year. However, Congress has now passed a Gramm-Rudman target requiring \$23 billion in deficit reductions. If such a reduction is not achieved, across-the-board expenditures cuts shared by defense and social programs will be initiated. As a result, deficits may continue to decline the next fiscal year.

Next year, interest rate prospects depend heavily upon the sentiments of foreign investors. If those investors are reluctant to acquire American assets, as we assume, the dollar will fall in value while foreign investors will demand higher interest rates in order to acquire American debt instruments. The yen

may appreciate to 125 to the dollar and the Deutsch mark may strengthen to 1.65 marks to the dollar in the early months of 1988. Of course, once the dollar reaches a low point from which only increases can be anticipated, foreign investors will become much more willing to purchase American bonds. For that reason, interest rates are not expected to increase dramatically next year.

Equity Markets - Many equity investors are looking for signs of the last surge in investing activity that normally dictates the top of a bull market. This surge typically is represented by a significant broadening of price increases and a significant increase in small investor activity. However, the equity markets may not show that pattern during this cycle. Just as institutional changes have altered the relationship between the money stock and economic activity, behavioral changes have altered the responsiveness of the equity markets to investment by small holders. While some analysts are waiting for the small investor to enter the market, sales of mutual funds suggest that the small investor has aggressively been a part of this market for more than a year. However, instead of making their own stock selections, these investors have entrusted their funds to the professionals that run mutual funds. As a result, the small investor's money is being invested through professional management eyes. These professional managers have no inclination to go toward less popular securities. As a result, the equity markets probably will not broaden their base or rally sharply before turning down.

Although Robert Prechter still maintains that one last wave of speculative surge will occur before this market ends its up trend, he is somewhat disturbed by the obvious bear market in bonds. Can investors really be so enthusiastic in buying equities when they obviously are depressed when they think of bonds? To be sure, equity markets can continue to move upward long after bond markets have reversed direction. However, the longest that a discrepancy between the two markets appears to have developed was in 1928 and 1929, when the bond market collapse predated equity markets by eighteen months. If the bond market is assumed to have peaked in April 1986, when the lowest yields on long-term treasury securities were attained, then the eighteen month discrepancy between the bond and stock market will have been achieved by this November. On the other hand, if the bear market in bonds is dated only from this April, then a discrepancy between the two markets could be historically supported until the latter half of 1988.

Given our analysis that the economic cycle is in its last up phase, the stock market probably will peak by the beginning of 1988. At that time, rising finance costs and higher wage pressures will begin to erode the earnings that currently are being enhanced by inflationary pressures. With both earnings and interest rates signalling lower stock prices, it would be very difficult indeed for the market to continue rising. Thus, the peak in the equity markets is not far away. For those who are becoming nervous, liquidations of stock positions at this time will not deprive investors of significant appreciation opportunities.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	101598	101598	119.6	119.6	111835	111835	6.3	6.3	172.6	172.6
May	101672	101708	120.2	120.2	112447	112447	6.3	6.3	172.7	172.9
June	101788	101818	120.1	120.0	112257	112257	6.1	6.1	173.1	172.9
July	101973	102114	120.4	120.6	112462	112727	6.2	6.0	173.5	173.2
August	102150	102270	120.6	121.2	112653	113081	6.1	6.0	173.9	173.9
September	102327	102507*	120.9	121.6*	113171	113431*	6.2	6.0*	174.6	174.3*
October	102485	102774	120.9	121.9	113029	113639	6.3	6.0	174.7	174.7
November	102628	102951	121.0	122.1	113292	113855	6.3	5.9	175.0	175.1
December	102771	103137	121.2	122.3	113556	114070	6.2	5.9	175.2	175.5
January 1988	102965	103408	121.4	122.6	113769	114389	6.2	5.7	175.8	175.9
February	103163	103594	121.7	122.8	113970	114561	6.2	5.8	176.6	176.3
March	103360	103780	122.1	123.0	114173	114788	6.1	5.7	177.4	176.8
April	103526	103966	122.2	123.2	114388	115009	6.2	5.7	177.8	177.3
May	103693	104184	122.4	123.5	114595	115268	6.2	5.6	178.3	177.9
June	103860	104371	122.5	123.7	114804	115479	6.1	5.6	178.9	178.5
July	104051	104557	122.7	123.9	114992	115719	6.1	5.5	179.5	179.1
August	104225	104743	123.0	124.1	115134	115865	6.0	5.5	180.1	179.9
September	104400	104837	123.3	124.2	115276	116058	6.1	5.5	180.7	180.5

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	3.700	3.704	2.182	2.182	32.9	42.3	3.067	3.070	3.034	3.028
May	3.718	3.713	2.193	2.194	146.4	136.7	3.176	3.171	3.030	3.035
June	3.731	3.715	2.201	2.199	122.3	101.1	3.173	3.157	3.050	3.056
July	3.749	3.732	2.211	2.208	122.8	92.6	3.190	3.171	3.067	3.078
August	3.765	3.750	2.220	2.227	119.5	58.6	3.204	3.182	3.085	3.123
September	3.782	3.770*	2.228	2.240*	99.3	64.9*	3.220	3.197*	3.121	3.132*
October	3.795	3.791	2.236	2.253	111.2	101.7	3.229	3.215	3.118	3.113
November	3.809	3.808	2.244	2.263	105.0	97.0	3.238	3.228	3.133	3.131
December	3.825	3.826	2.252	2.274	100.8	88.0	3.249	3.241	3.148	3.153
January 1988	3.834	3.839	2.265	2.286	128.7	111.9	3.296	3.290	3.167	3.178
February	3.855	3.857	2.277	2.297	124.9	109.4	3.308	3.310	3.183	3.201
March	3.886	3.876	2.290	2.308	111.7	108.4	3.315	3.327	3.203	3.219
April	3.907	3.897	2.301	2.320	117.3	128.0	3.336	3.344	3.219	3.216
May	3.919	3.920	2.313	2.335	121.3	120.0	3.353	3.362	3.232	3.242
June	3.931	3.941	2.325	2.349	122.7	118.9	3.370	3.379	3.247	3.260
July	3.955	3.962	2.337	2.362	120.1	118.8	3.383	3.395	3.263	3.276
August	3.978	3.986	2.349	2.378	112.8	114.3	3.397	3.413	3.284	3.299
September	4.001	4.005	2.361	2.389	109.2	114.7	3.411	3.427	3.302	3.312

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	2939.7	2933.8	411.6	408.1	979.3	976.8	1548.8	1548.9	2497.0	2488.1
May	2935.2	2940.6	403.8	402.3	977.3	983.4	1554.7	1555.0	2481.2	2482.1
June	2956.3	2961.8	413.6	415.8	974.4	985.6	1568.3	1560.4	2487.9	2493.9
July	2973.2	2983.7	414.3	417.9	979.5	988.9	1579.4	1577.0	2492.2	2508.7
August	2990.1	3028.1	412.8	447.7	988.3	992.5	1589.0	1587.9	2498.0	2542.8*
September	3025.9	3037.0*	429.6	443.9*	997.7	997.3*	1598.6	1595.8*	2521.6	2541.8
October	3022.6	3017.8	415.5	411.7	1000.6	1001.5	1606.5	1604.6	2510.5	2513.2
November	3037.5	3035.1	419.4	417.5	1002.6	1004.3	1615.5	1613.3	2516.6	2519.6
December	3052.4	3056.7	423.4	425.2	1004.7	1009.0	1624.3	1622.5	2522.6	2531.1
January 1988	3071.3	3081.4	425.8	436.0	1010.6	1013.5	1634.9	1631.9	2527.8	2542.9
February	3087.0	3103.5	422.7	442.9	1018.9	1018.3	1645.4	1642.3	2532.4	2552.7
March	3107.3	3121.0	424.4	444.9	1026.9	1023.1	1656.0	1653.0	2538.6	2558.9
April	3122.3	3118.0	427.1	426.4	1030.4	1027.9	1664.8	1663.7	2540.5	2545.9
May	3135.0	3143.5	427.5	436.9	1033.6	1033.2	1673.9	1673.4	2542.6	2560.3
June	3152.8	3161.1	433.0	439.4	1036.8	1038.6	1683.0	1683.1	2548.7	2565.9
July	3170.9	3176.8	433.8	439.8	1042.5	1043.4	1694.6	1693.6	2553.1	2568.4
August	3186.7	3198.8	432.5	448.2	1048.3	1047.4	1705.9	1703.2	2555.5	2576.8
September	3204.0	3211.8	432.7	444.7	1054.1	1052.6	1717.2	1714.5	2561.2	2576.6

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	124.96	124.96	20.03	20.03	10.4	10.5	76.83	76.83	28.10	28.10
May	124.55	124.87	20.07	20.00	9.7	9.9	76.86	77.08	27.61	27.78
June	125.08	126.62	19.98	20.05	10.2	10.2	76.97	77.54	28.13	29.04
July	125.60	126.99	20.30	20.19	10.2	10.5	77.08	77.63	28.22	29.17
August	126.12	128.61	20.19	19.99	10.1	12.4	77.78	78.13	28.15	30.49
September	128.83	128.95*	20.07	20.18*	11.0	11.2*	78.52	78.51*	30.24	30.26*
October	127.33	125.62	20.27	20.25	9.6	8.9	79.14	78.84	27.89	26.53
November	128.01	126.77	20.34	20.27	10.0	9.3	78.90	79.06	28.77	27.44
December	129.15	128.30	20.02	20.21	10.5	9.9	79.07	79.43	30.06	28.66
January 1988	129.39	129.89	20.02	20.19	10.4	10.2	79.53	79.78	29.84	29.96
February	129.68	131.07	19.94	20.22	10.2	10.5	80.18	80.16	29.56	30.69
March	130.51	131.68	19.97	20.29	10.3	10.6	80.81	80.54	29.73	30.85
April	131.10	129.93	20.09	20.34	10.4	9.8	81.09	80.92	29.92	28.67
May	131.40	131.55	20.08	20.37	10.4	10.2	81.34	81.33	29.98	29.85
June	132.30	132.26	20.52	20.46	10.5	10.3	81.59	81.76	30.19	30.04
July	132.84	132.69	20.75	20.42	10.4	10.3	82.04	82.14	30.05	30.13
August	133.15	133.97	20.69	20.37	10.3	10.9	82.50	82.45	29.96	31.15
September	133.62	133.97	20.65	20.44	10.3	10.6	82.95	82.85	30.02	30.67

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	1.686	1.643	1.238	1.208	1.586	1.598	397.3	397.1	349.2	349.1
May	1.598	1.606	1.115	1.130	1.487	1.493	398.6	397.7	349.6	348.8
June	1.552	1.586	1.067	1.088	1.469	1.517	394.0	392.4	345.0	342.7
July	1.588	1.606	1.103	1.150	1.503	1.487	391.9	391.8	342.0	339.9
August	1.611	1.582	1.122	1.098	1.516	1.486	393.5	391.4*	341.9	338.0*
September	1.620	1.568*	1.126	1.103*	1.528	1.453*	395.6	391.4	342.5	336.5
October	1.618	1.544	1.134	1.076	1.511	1.427	395.2	391.6	341.3	335.6
November	1.629	1.514	1.143	1.053	1.515	1.389	395.2	390.9	340.4	333.5
December	1.621	1.522	1.130	1.069	1.501	1.407	394.8	388.7	338.9	330.2
January 1988	1.583	1.492	1.108	1.024	1.492	1.382	396.9	388.3	339.8	328.2
February	1.560	1.471	1.083	0.998	1.467	1.369	399.0	387.9	340.7	326.2
March	1.552	1.508	1.086	1.017	1.473	1.381	401.3	387.7	341.5	324.4
April	1.588	1.494	1.115	1.011	1.489	1.386	401.9	387.6	341.2	323.0
May	1.609	1.479	1.139	1.003	1.521	1.384	403.4	389.5	341.6	323.8
June	1.608	1.467	1.130	0.985	1.518	1.353	404.9	391.7	341.7	324.3
July	1.589	1.465	1.116	0.981	1.493	1.367	409.4	392.0	344.3	323.4
August	1.595	1.476	1.102	0.989	1.498	1.381	412.0	392.2	345.3	322.3
September	1.592	1.481	1.104	0.994	1.492	1.386	414.1	393.2	346.2	322.0

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	121.4	121.3	76.7	76.3	199.2	199.5
May	123.8	126.8	75.8	75.0	198.9	195.9
June	123.0	121.7	76.1	72.3	194.9	198.3
July	122.3	120.4	77.0	73.2	192.6	198.2
August	122.0	119.6*	77.8	74.0*	193.7	197.8*
September	122.0	119.2	78.7	74.5	194.9	197.7
October	121.7	119.0	78.0	74.9	195.5	197.7
November	121.4	118.7	77.8	76.1	196.0	196.1
December	121.1	118.3	77.5	76.0	196.2	194.4
January 1988	121.4	117.8	78.8	76.5	196.7	194.0
February	121.6	117.5	80.1	77.1	197.3	193.3
March	121.9	117.6	81.5	77.7	197.9	192.4
April	122.5	117.5	80.7	77.5	198.7	192.6
May	122.8	117.8	81.1	78.0	199.5	193.7
June	123.2	118.4	81.5	78.4	200.2	194.9
July	123.8	118.2	81.9	78.9	203.7	194.3
August	124.4	118.5	82.1	79.4	205.5	194.3
September	125.1	118.6	82.4	79.8	206.6	194.8

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	320.8	320.8	106.93	106.98	28.30	28.31	27.33	27.32
May	321.5	321.8	106.98	106.99	29.99	30.03	26.95	26.97
June	321.4	321.6	108.53	109.18	29.09	29.99	27.61	27.85
July	321.9	323.0	109.24	109.17	29.93	31.98	27.53	28.10
August	322.5	324.2*	107.65	105.77	28.65	29.29	27.65	28.40
September	322.9	325.1	105.46	106.93*	27.84	29.43*	27.79	28.57*
October	323.6	326.0	105.93	107.82	27.95	29.69	27.85	28.69
November	324.3	326.7	106.81	109.16	28.13	29.85	27.96	28.76
December	324.8	327.6	107.16	109.43	28.42	29.83	28.33	29.08
January 1988	325.3	328.3	107.03	107.72	28.06	28.82	27.46	28.43
February	326.0	329.2	107.42	106.97	28.31	28.86	27.83	28.69
March	326.9	330.0	107.95	107.82	28.59	28.97	28.21	28.83
April	328.1	330.7	106.64	108.43	28.47	29.16	28.25	29.11
May	329.0	331.6	106.93	108.95	28.53	29.25	28.33	29.24
June	329.3	332.4	107.72	109.91	28.69	29.13	28.24	29.21
July	330.0	333.2	107.59	109.86	28.75	29.52	28.43	29.37
August	331.4	334.1	108.86	109.27	28.89	29.73	28.55	29.48
September	331.8	335.0	109.43	108.56	29.06	29.59	28.72	29.65

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	665.9	665.9	8.76	8.76	127.3	127.4	79.4	79.5
May	670.4	671.6	9.23	9.24	128.0	128.4	79.7	80.0
June	669.2	674.8	9.36	9.44	128.2	129.2	79.7	80.4
July	673.4	676.2	9.45	8.91	128.7	130.3	79.9	80.9
August	677.5	677.6*	9.36	8.86	129.0	130.7	80.0	81.0
September	678.1	678.5	9.40	9.17*	129.3	131.1*	80.0	81.1*
October	682.5	681.4	9.46	9.25	129.6	131.4	80.1	81.2
November	685.3	684.0	9.55	9.33	129.8	131.7	80.1	81.3
December	687.4	686.6	9.63	9.42	130.1	132.0	80.1	81.3
January 1988	691.5	689.4	9.69	9.40	130.4	132.5	80.1	81.5
February	694.3	692.5	9.76	9.46	130.9	132.9	80.3	81.6
March	696.1	695.1	9.77	9.43	131.3	133.3	80.4	81.7
April	699.2	698.3	9.83	9.52	131.6	133.6	80.4	81.8
May	702.5	700.9	9.89	9.70	132.0	134.2	80.5	82.0
June	704.6	703.8	9.95	9.78	132.4	134.5	80.6	82.0
July	707.8	707.0	10.03	9.60	132.8	134.9	80.7	82.1
August	709.6	710.2	10.09	9.53	133.2	135.3	80.9	82.2
September	712.9	713.4	10.15	9.66	133.6	135.4	81.0	82.1

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PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	337.9	337.9	295.3	295.3	317.4	317.3	116.9	116.7
May	339.0	339.0	296.2	296.2	318.6	318.6	117.2	117.2
June	340.4	340.2	296.8	296.9	320.2	320.2	117.6	117.5
July	341.2	341.0	296.7	297.4	321.8	322.6	118.0	117.7
August	342.5	342.7	297.3	297.3	322.6	323.0	118.4	118.0
September	343.8	344.1*	298.0	298.5*	321.0	323.2	118.8	118.4
October	344.6	345.3	298.5	299.3	323.1	325.0	119.0	118.9
November	345.5	346.5	299.1	300.1	323.6	325.8	119.3	119.3
December	346.4	347.8	299.5	300.9	324.2	326.7	119.6	119.7
January 1988	347.6	349.1	300.1	301.6	325.8	327.5	120.0	120.1
February	348.7	350.4	300.6	302.2	327.6	328.1	120.5	120.5
March	349.9	351.3	301.2	302.7	329.3	328.6	120.9	120.9
April	351.4	352.3	302.5	303.3	330.5	329.7	121.3	121.4
May	353.0	353.8	303.8	304.3	331.0	330.9	121.7	121.7
June	354.6	355.4	304.1	305.0	331.5	332.0	122.1	122.1
July	356.0	356.8	305.5	305.8	333.9	333.1	122.5	122.6
August	357.1	358.2	305.8	306.6	335.0	334.4	123.0	123.1
September	358.3	359.6	306.3	307.5	333.7	332.6	123.4	123.6

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	117.7	117.9	106.0	105.9	111.1	111.2	126.2	126.5	113.8	113.8
May	118.3	118.5	105.9	105.9	111.8	111.8	126.8	127.2	114.0	114.0
June	118.8	118.8	106.2	106.6	112.4	112.2	127.3	127.3	114.2	114.5
July	119.3	118.9	106.6	106.7	112.8	112.2	127.8	127.6	114.6	115.3
August	119.7	119.1*	107.0	106.6*	113.2	112.5*	128.2	128.0*	115.1	115.8*
September	120.0	119.5	107.3	107.0	113.5	112.8	128.6	128.4	115.5	116.3
October	120.4	120.1	107.3	107.3	113.8	113.2	129.0	128.9	115.8	116.7
November	120.7	120.5	107.4	107.6	114.1	113.5	129.5	129.4	116.1	117.2
December	121.0	120.8	107.5	107.8	114.4	113.8	130.0	129.8	116.5	117.7
January 1988	121.5	121.2	107.8	108.2	114.8	114.2	130.5	130.3	116.8	118.3
February	121.9	121.6	108.0	108.4	115.1	114.6	131.0	130.8	117.1	118.9
March	122.4	122.0	108.2	108.7	115.4	115.0	131.5	131.2	117.5	119.5
April	122.9	122.5	108.5	109.0	115.9	115.3	132.0	131.7	117.8	120.0
May	123.3	122.8	108.8	109.3	116.4	115.6	132.6	132.1	118.1	120.3
June	123.7	123.2	109.1	109.5	116.8	116.0	133.2	132.6	118.5	120.8
July	124.2	123.7	109.4	109.8	117.3	116.4	133.8	133.2	118.9	121.2
August	124.7	124.1	109.6	110.1	117.8	116.8	134.3	133.8	119.3	121.7
September	125.1	124.7	109.9	110.4	118.2	117.2	134.7	134.4	119.6	122.1

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	-13.32	-13.32	186.6	187.9	4420	4410	3781	3779	-15.9	-18.3
May	-14.40	-14.04	187.5	188.9	4452	4453	3799	3799	-20.3	-21.9
June	-14.00	-15.71	188.0	190.8	4474	4472	3804	3806	-22.9	-24.3
July	-14.63	-16.47	188.6	191.8	4502	4491	3815	3816	-16.3	-17.6
August	-14.27	-14.65*	188.9	192.4*	4524	4522*	3821	3832*	-10.5	-13.9*
September	-13.60	-14.26	189.4	191.9	4546	4548	3827	3841	-7.4	-16.5
October	-12.96	-13.77	189.0	191.3	4563	4570	3834	3844	-9.5	-16.3
November	-13.55	-14.46	188.6	191.7	4575	4598	3835	3854	-13.4	-13.6
December	-13.73	-14.65	189.1	192.2	4594	4624	3841	3863	-15.5	-12.5
January 1988	-13.26	-14.45	188.7	191.8	4622	4648	3852	3870	-16.2	-11.8
February	-12.43	-13.92	188.2	192.2	4657	4678	3865	3882	-17.1	-14.3
March	-11.86	-13.67	187.8	192.5	4680	4706	3871	3892	-17.1	-16.2
April	-12.24	-12.95	187.2	192.0	4701	4727	3876	3894	-16.3	-16.9
May	-12.85	-13.46	188.0	191.6	4735	4753	3891	3906	-15.4	-16.5
June	-12.76	-13.65	188.3	191.3	4771	4779	3907	3914	-14.5	-14.6
July	-13.56	-14.29	188.9	191.0	4795	4804	3914	3918	-13.9	-14.5
August	-13.02	-13.82	189.2	191.5	4816	4836	3915	3929	-13.2	-15.4
September	-11.90	-13.52	189.3	191.8	4838	4860	3921	3932	-13.5	-16.6

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	262.2	262.2	750.4	750.3	2839.1	2837.9	6.37	6.37	5.90	5.90
May	263.4	263.4	753.2	753.1	2840.1	2838.7	6.85	6.85	6.05	6.05
June	263.8	263.4	746.7	746.6	2842.8	2840.2	6.73	6.73	5.99	5.99
July	264.4	264.3	748.5	747.6	2854.3	2846.2	6.56	6.58	5.88	5.76
August	265.5	266.3	750.6	750.9	2868.1	2860.2	6.65	6.73	5.80	6.15
September	266.7	268.8*	752.9	752.7*	2881.8	2870.4*	6.68	7.07*	5.83	6.48*
October	268.9	270.1	758.4	759.0	2898.3	2887.6	6.73	7.36	5.86	6.70
November	270.8	271.5	763.1	763.2	2913.6	2904.9	6.70	7.43	5.93	6.75
December	272.6	272.9	767.9	767.1	2925.7	2919.7	6.59	7.35	6.02	6.63
January 1988	274.5	274.4	773.5	771.1	2948.2	2933.9	6.43	7.16	5.79	6.36
February	276.4	275.8	779.4	774.4	2967.5	2948.6	6.34	7.05	5.70	6.21
March	278.3	277.5	785.5	779.8	2986.6	2968.5	6.25	7.20	5.65	6.42
April	280.0	279.2	790.3	783.2	3003.5	2984.4	6.38	7.28	5.88	6.45
May	281.7	280.9	796.1	789.3	3020.2	3005.3	6.69	7.44	6.01	6.56
June	283.4	282.5	801.8	794.1	3036.9	3023.6	6.94	7.53	6.13	6.73
July	285.1	283.9	805.2	799.2	3054.5	3043.0	6.73	7.58	6.08	6.79
August	286.8	285.4	809.1	803.7	3072.4	3060.1	6.56	7.55	5.93	6.88
September	288.5	286.9	813.0	808.8	3090.1	3079.5	6.57	7.52	5.80	6.81

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	8.85	8.85	7.55	7.55	6.45	6.45	6.52	6.52	7.75	7.75
May	9.33	9.33	8.00	8.00	6.93	6.93	6.99	6.99	8.14	8.14
June	9.32	9.32	7.79	7.79	6.92	6.92	6.94	6.94	8.25	8.25
July	9.42	9.42	7.68	7.72	6.67	6.65	6.75	6.70	8.25	8.25
August	9.50	9.67	7.74	7.82	6.65	6.71	6.73	6.75	8.25	8.25
September	9.50	10.26*	7.70	8.34*	6.73	7.32*	6.84	7.34*	8.25	8.62*
October	9.59	10.47	7.82	8.48	6.78	7.43	6.89	7.48	8.25	8.75
November	9.57	10.69	7.77	8.71	6.75	7.45	6.83	7.53	8.25	9.03
December	9.54	10.63	7.73	8.64	6.55	7.40*	6.67	7.47	8.25	9.25
January 1988	9.33	10.52	7.52	8.52	6.40	7.27	6.53	7.36	8.25	9.25
February	9.18	10.22	7.34	8.25	6.26	7.06	6.39	7.16	8.25	9.25
March	9.21	10.16	7.37	8.18	6.25	7.17	6.35	7.25	8.25	9.25
April	9.37	10.43	7.54	8.45	6.41	7.31	6.52	7.39	8.25	9.25
May	9.48	10.59	7.64	8.63	6.68	7.46	6.79	7.53	8.25	9.25
June	9.59	10.81	7.75	8.83	6.95	7.59	7.06	7.65	8.25	9.38
July	9.33	10.96	7.48	9.00	6.76	7.63	6.89	7.72	8.25	9.50
August	9.21	11.03	7.37	9.05	6.53	7.62	6.65	7.70	8.25	9.50
September	9.09	11.01	7.24	9.04	6.50	7.65	6.63	7.76	8.25	9.50

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